87-204

No. ___-___

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

October Term, 1987

EXPLOSIVES CORPORATION OF AMERICA,
GENERAL INSURANCE COMPANY OF AMERICA,
ROCKCOR, INC.,
Petitioners,

v.

GARLAM ENTERPRISES CORPORATION
AND FEDERAL INSURANCE COMPANY, INC.,
Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

STUART G. OLES
Counsel of Record, and
ARTHUR D. McGARRY
DOUGLAS S. OLES
OLES, MORRISON, RINKER,
STANISLAW & ASHBAUGH
3300 Columbia Seafirst Center
701 Fifth Avenue
Seattle, WA 98104
(206) 623-3427

SALVADOR ANTONETTI
FIDDLER, GONZALEZ & RODRIGUEZ
G.P.O. Box 3507
San Juan, Puerto Rico 00936
(819) 753-3113
Attorneys for Petitioners

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aBCD Legal Printers, Seattle, Washington

QUESTIONS PRESENTED

1. Does Rule 25(c), Fed. R. Civ. P., require that a nonparty who finances or controls litigation (involving a contract to which he is also not party) be substituted and held liable to pay any adverse judgment?

2. If a subcontractor is terminated for default, does it become liable not only for the reasonable cost of performing the task contemplated by its subcontract, but also the cost of performing a much larger and longer task?

LIST OF PARTIES

Petitioners are Explosives Corporation of America, General Insurance Company of America, and Rockcor, Inc., all Washington corporations.

Safeco Corporation wholly owns General Insurance Company of America. Olin Corporation wholly owns Rockcor, Inc. As developed *infra*, Explosives Corporation of America has been dissolved.

Respondents are Garlam Enterprises Corporation and Federal Insurance Company, Inc., its surety.

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

OPINION BELOW

The First Circuit's Opinion, reported at 817 F.2d 894 (1st Cir. 1987), appears in the Appendix ("A.") to this petition at pp. 1-62.

JURISDICTION

The First Circuit's Opinion and Judgment were entered April 30, 1987. A Petition for Rehearing and Request for Hearing *En Banc* was denied by order dated June 3, 1987. This petition was filed within ninety days thereafter. The Court's jurisdiction is invoked under 28 U.S.C. §1254(1).

STATUTORY PROVISIONS AND COURT RULES INVOLVED

Revised Code of Washington § 23A.28.250:

Survival of remedy after dissolution. The dissolution of a corporation either: (1) By the issuance of a certificate of dissolution by the secretary of state, or (2) by a decree of court, or (3) by expiration of its period of duration shall not take away or impair any remedy available to or against such corporation, its directors, officers, or shareholders, for any right or claim existing, or any liability incurred, prior to such dissolution if action or other proceeding thereon is commenced within two years after the date of such dissolution. The directors of any such corporation shall hold title to the property of the corporation as trustees for the benefit of its creditors and shareholders. Any such action or proceeding by or against the corporation may be prosecuted or defended by the corporation in its corporate name. The shareholders, directors, and officers shall have power to take such corporate or other action as shall be appropriate to protect such remedy, right, or claim.

Rule 25(c), Fed. R. Civ. P.:

(c) Transfer of Interest. In case of any transfer of interest, the action may be continued by or against the original party, unless the court upon motion directs the person to whom the interest is transferred to be substituted in the action or joined with the original party. Service of the motion shall be made as provided in subdivision (a) of this rule.

(b) Capacity to Sue or be Sued. The capacity of an

Rule 17(b), Fed. R. Civ. P.:

> *(b) Capacity to Sue or be Sued.* The capacity of an individual, other than one acting in a representative capacity, to sue or be sued shall be determined by the law of his domicile. The capacity of a corporation to sue or be sued shall be determined by the law under which it was organized. In all other cases capacity to sue or be sued shall be determined by the law of the state in which the district court is held, except (1) that a partnership or other unincorporated association, which has no such capacity by the law of such state, may sue or be sued in its common name for the purpose of enforcing for or against it a substantive right existing under the Constitution or laws of the United States, and (2) that the capacity of a receiver appointed by a court of the United States to sue or be sued in a court of the United States is governed by Title 28, U.S.C. §§ 754 and 959(a).

STATEMENT OF THE CASE

The following facts are undisputed or established by the district court and affirmed by the circuit court of appeals.

The case arises from a 1971 subcontract for rock blasting involved in constructing a freeway for the Puerto Rico Highway Authority ("Highway Authority"). Explo[1] was the subcontractor, and Garlam Enterprises Corporation ("Garlam") was the prime contractor. General Insurance Company of America ("General Insurance") bonded Explo's performance to Garlam for $1,230,000.

[1] The original subcontract was executed by Garlam and "Explo Contractors, a Division of Explosives Corporation of America" (A. 71). In 1973, Explosives Corporation of America merged into Excoa, Inc., which in turn became insolvent and dissolved in 1976. For convenience, we refer to these Rockcor, Inc. subsidiaries collectively as "Explo." The circuit court has referred to them collectively as Explo-Excoa.

1. Rockcor Was Substituted Under Civil Rule 25(c) Because It Financed and Controlled Explo's Litigation.

Garlam terminated Explo's subcontract for default. Explo sued in federal court (diversity of citizenship jurisdiction) for breach of contract, and Garlam counterclaimed for costs to complete Explo's subcontract work.

Meanwhile, Explo became insolvent. Its main creditor was its Washington parent corporation, Rockcor, Inc. ("Rockcor"). In 1976 Rockcor foreclosed its security interests, and thereby took an assignment of Explo's assets, including the affirmative claim against Garlam. (Rockcor was also indirectly interested in the litigation because it was indemnitor to General Insurance of Explo's bond.) Subsequently, after a bifurcated trial, the district court ruled that Explo was liable for the reasonable excess costs of completing its subcontract.

Garlam perceived that the amount of its damages might exceed the limits of Explo's bond. Thus, in 1977, it moved to join Rockcor as an *alter ego* codefendant with Explo. In 1979, joinder was denied because Rockcor and Explo "were separate and distinct corporate entities" (A. 128-29). In 1985, the trial court reiterated that "evidence of corporate disregard has not been presented in this case" (A. 302).

Garlam also moved to substitute Rockcor for Explo under Rule 25(c), Fed. R. Civ. P., because Rockcor had acquired assets from Explo (including its claim against Garlam) when Explo dissolved in 1976. The district court denied substitution because no facts established any of the four traditional grounds (*see, e.g., R. J. Engstrom Corp. v. Interceptor Corp.*, 555 F.2d 277, 281-282 (10th Cir. 1977)) for successor liability under Civil Rule 25(c).[2]

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[2] First, Rockcor never expressly or impliedly assumed liability for Garlam's counterclaim against Explo (A. 291). Second, there was no allegation of any merger or consolidation between Explo and Rockcor (A. 293). Third, when Explo dissolved in 1976, its name

(see next page)

On appeal, the circuit court acknowledged "the fact that Rockcor was a separate entity from Explo-Excoa and that Rockcor did not assume Explo-Excoa's liabilities". A. 49. Further, it concluded "that the district court did not make any clearly erroneous findings of fact". A. 4.[3] Thus, Garlam did not establish Rockcor's *alter ego* liability or any of the four fact situations in which successors have traditionally been substituted under Rule 25(c), Fed. R. Civ. P.

Nonetheless, the circuit court reversed the trial court, holding that Rockcor must be substituted for Explo under Rule 25(c), Fed. R. Civ. P., because Rockcor after 1976 financed and controlled Explo's litigation. The circuit court cited and relied upon collateral estoppel cases: "It has long been the rule that a nonparty who controls the litigation is bound by the judgment." A. 53.

2. The Terminated Subcontractor Was Charged With the Prime Contractor's Costs of Completing a Much Larger and Longer Task Than the Original Subcontract.

After terminating Explo's subcontract, Garlam completed rock blasting. Due to the project owner's design errors and other causes not attributed to Explo,[4] Garlam had to complete

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and operations were discontinued, and Rockcor was not a "mere continuation" of Explo (A. 296-98). Fourth, Explo's residual assets were not transferred to Rockcor for any fraudulent purpose (A. 307-8).

[3] Pertinently, one of those findings was that when Rockcor acquired Explo's "interest in and to the lawsuit," Rockcor took only the asset, to wit, the net recovery against Garlam, and did not assume any liability to Garlam (A. 290-91). This was supported by Rockcor's chairman's uncontroverted testimony which the circuit court acknowledged was the only testimony on the issue (A. 44).

[4] The record below confirms that Explo was not responsible for any project delay or overrun in the quantities of rock blasting (A. 177-87).

a much larger and longer task than the one originally subcontracted to Explo. The rock blasting quantity overran both the Highway Authority's estimate (1,507,000) and Garlam's (2,000,000) to 2,996,368 cubic meters (A. 165). Contract time increased from 600 to 2,152 days (A. 149).

Explo pointed out that it should receive credit (as an offset against Garlam's damage award) for an increased unit price (above its original $0.51 per cubic meter) as to blasting materially beyond the quantities and time period of its subcontract. Citing unchallenged federal case authority, Explo argued that it could not be charged with costs of completing a materially larger contract.

Explo also pointed to subcontract provisions that guaranteed a renegotiated unit price for excess quantities of rock blasting.[5] Despite these guarantees incorporated by

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[5] Article I of Explo's sub-contract provided that the "general and special conditions" of Garlam's prime contract are "hereby made a part of this Agreement" (A. 74). General Condition 4.3 guaranteed renegotiated unit prices for any work that overran by more than 25 percent "in dollars or in extent" (A. 69-70). It is undisputed that the quantities, costs, and duration of rock blasting on the Puerto Rico project all overran by considerably more than 25 percent. Nonetheless, no unit price adjustment was used in calculating Garlam's recovery against Explo. In addition, Article XVII(d) in Explo's subcontract provided that ". . . the Contractor shall be bound to the subcontractor . . . by all the obligations that the Owner assumes toward the Contractor . . . and by all [prime contract] provisions affording remedies and redress." A. 76. Article VII in Explo's subcontract further recites "[t]hat the Subcontractor shall be bound by any changes or alterations ordered by the Owner in the work under this Agreement in the General Contract, specifications, general and special provisions, and/or plans, or in the amount or character of said work or any part thereof, to the same extent that the Contractor is bound thereby, the payments to the Subcontractor to be adjusted accordingly." A. 75.

reference into the subcontract from provisions in the prime contract, the court of appeals simply stated that "[t]here was . . . no such provision in Explo's contract." A. 16.

REASONS FOR GRANTING THE WRIT

1. By Requiring Substitution of a Nonparty Under Civil Rule 25(c) Because It Financed and Controlled Explo's Litigation, the First Circuit's Decision Conflicts With Decisions of This Court and of Other Circuits.

A. The First Circuit Confused Collateral Estoppel With Successor Liability Under Rule 25(c), Fed. R. Civ. P.

Rule 25(c), Fed. R. Civ. P., pertinently provides:

> In case of any transfer of interest, the action may be continued by or against the original party, unless the court upon motion directs the person to whom the interest is transferred to be substituted in the action or joined with the original party.

Parent corporations have sometimes been substituted under Rule 25(c) for their subsidiaries where evidence demonstrated a disregard for the corporate separation between them (i.e., *alter ego* liability). In four limited factual situations, courts have also allowed substitution to facilitate collection against assets that have been transferred from a judgment debtor to a third party.[6]

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[6] The First Circuit has itself recently reiterated the rule that a purchaser of corporate assets is only liable for obligations of the transferor in four limited fact situations:

> (1) when the purchasing corporation expressly or impliedly agreed to assume the selling corporation's liability; (2) when the transaction amounts to a consolidation or merger of the purchaser and seller corporations; (3) when the

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As emphasized previously, the trial court found no factual basis for substitution of parties under Rule 25(c), Fed. R. Civ. P. There was no evidence of disregard for the corporate separation between Rockcor and Explo (hence, no *alter ego* liability),[7] and there were none of the four fact situations in which federal courts have traditionally found a "transfer of interest." *See* note 2, *supra* at p.4.

Now, while expressly accepting the trial court's factual findings (A. 4, 44), the First Circuit has conceived a new and unprecedented standard for substituting parties under Rule 25(c), Fed. R. Civ. P. It has ordered substitution based[8] upon

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> purchaser corporation is merely a continuation of the seller corporation; or (4) when the transaction is entered into fraudulently to escape liability for such obligations.

Dayton v. Peck, Stow & Wilcox Co., 739 F.2d 690, 692 (1st Cir. 1984). The U. S. Supreme Court and various circuit courts have confirmed that these are the only factual circumstances in which a transfer of assets amounts to a transfer of interest (the standard for substitution of nonparties under Civil Rule 25(c)). *See Golden State Bottling Co. v. NLRB*, 414 U.S. 168, 182 n.5 (1973); *Gee v. Tenneco, Inc.*, 615 F.2d 857, 863 (9th Cir. 1980); *Leannais v. Cincinnati, Inc.*, 565 F.2d 437, 439 (7th Cir. 1977); *R. J. Enstrom Corp. v. Interceptor Corp.*, 555 F.2d 277, 281-82 (10th Cir. 1977).

[7] In *Peterick v. State*, 22 Wn. App. 163, 184-85, 589 P.2d 250, 264-65 (1977), another court also found that Rockcor was not an *alter ego* of Explo.

[8] After requiring that Rockcor be substituted for Explo based on "Rockor's [sic] ownership of Explo-Excoa and its financing and control of the litigation," the First Circuit offers "another reason why Rockor [sic] is liable for the amount of the judgment against Explo":

> The contract between Explo and Garlam contained the following clause: "It is mutually agreed that this Agreement shall bind the heirs, executors, administrators, successors, holding companies and assigns of the parties hereto." It

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a finding "that Rockcor controlled the litigation at least since it took over Excoa's [Explo's] assets on October 29, 1976." A. 47. Applying what it calls the "underlying legal principle that a participating nonparty is bound by the judgment" (A. 51), the circuit court concludes that Rockcor could not finance or control Explo's defense without assuming liability for any adverse judgment that might be entered against Explo. Under this reasoning, Rockcor could only have avoided

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> cannot be doubted that Rockor [sic] was a successor to Explo. It also is evident that Rockor [sic], which owned all of the outstanding stock of Explo at the commencement of the action, was a holding company of Explo at the time the contract was executed.

A. 58-59. This is plain and egregious error under established law and undisputed facts.

The First Circuit assumes that Rockcor was bound by a subcontract to which it was not a party. The rock blasting subcontract was executed only by Garlam and Explo (A. 6-7), and there was no evidence that Rockcor agreed to be bound by the signature of its subsidiary. The district court expressly found that "Rockcor is not an 'assignee' of the subcontract and is not liable in such capacity for Explo's breach." (A. 293.)

Subsidiaries do not automatically have authority to act as agents for other corporations that control their stock. RESTATEMENT OF AGENCY, SECOND, § 14M at 79 (1958). In our case, no court has ever found (nor any party testified) that Explo had either actual or apparent authority to bind Rockcor for any purpose.

It is also circular reasoning for the First Circuit to recite that Rockcor is a "successor to Explo," because that conclusion rests on the theory that mere participation in a lawsuit creates successor liability.

Meanwhile, noting that a "holding company" is "a corporation organized to hold the stock of another or other corporations," (6A FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS 2821 (Perm. Ed. 1981)), the trial court expressly found that Rockcor was not a "holding company". A. 293.

liability by allowing Garlam to take a default judgment against the insolvent Explo (and against Explo's surety, to which Rockcor was obligated as indemnitor).

This inequitable and unique application of Rule 25(c) is based on a fundamental misunderstanding of the authorities on which the First Circuit relies. Although it is true that nonparties who participate in litigation may be "bound" by the resulting judgment, they are bound only in the sense of being precluded from relitigation of issues under principles of collateral estoppel.

Of the eight cases and two texts cited by the First Circuit, most deal only with collateral estoppel and contain no reference to Rule 25 or successor liability.[9] The remaining authorities actually confirm that successor liability is only imposed on participating nonparties in special circumstances that are absent in our case, e.g., *alter ego* control, bad faith, or fraudulent diversion of assets.[10] We are aware of no case

[9] *Montana v. United States*, 440 U.S. 147 (1979) (fed. govt. collaterally estopped from relitigating issues decided in lawsuit financed by govt.); *General Foods Corp. v. Massachusetts Dept. of Public Health*, 648 F.2d 784, 789 (1st Cir. 1981) (corporation estopped from relitigating issues previously decided in lawsuit by its trade association); *Kreager v. General Electric Co.* 497 F.2d 468, 471 (2d Cir. 1974) (shareholder estopped from pursuing claims previously litigated by his corporation); *Pan American Match, Inc. v. Sears, Roebuck & Co.*, 454 F.2d 871, 874 (1st Cir. 1972), *cert. denied* 409 U.S. 892 (1972) (plaintiff who lost case against Puerto Rico subsidiary was estopped from relitigating same issues against defendant's parent corporation); J. MOORE, J. LUCAS, T. CURRIER, 1B MOORE'S FEDERAL PRACTICE & PROCEDURE, ¶ 0.411[10] at 477-78 (1984 & Supp. 1986-87) (controlling stockholders are sometimes bound by judgments against their corporations under rules of res judicata and collateral estoppel).

[10] *Alman v. Danin*, 801 F.2d 1, 4 (1st Cir. 1986) (shareholders liable for corporate debt on *alter ego* theory because they disregarded the corporate entity); *Minnesota Min. & Mfg. Co. v. Eco Chem.*

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anywhere that holds that a nonparty's control of litigation imposes on the nonparty a duty to pay an adverse judgment.

The First Circuit's decision conflicts with all its own cited authorities by requiring Rule 25(c) substitution of a nonparty based on participation in the lawsuit of a subsidiary corporation.

B. The First Circuit's Opinion Conflicts With Decisions of the Supreme Court, of Other Circuit Courts, and With Long-Established Rules of Successor Liability.

The holding that ownership and control by a parent of litigation of a subsidiary allows, or even requires,[11] imposition of successor liability, is flatly at odds with decisions of this Court in *Golden State Bottling Co., supra*, and of other circuits

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Inc., 757 F.2d 1256, 1262 (Fed. Cir. 1985) (successor liability was appropriate where judgment debtor gratuitously transferred its assets to an *alter ego* corporation to avoid creditor); *Panther Pumps & Equipment v. Hydrocraft, Inc.*, 566 F.2d 8 (7th Cir. 1977), *cert. denied sub nom. Beck v. Morrison Pump Co., Inc.*, 435 U.S. 1013 (1978) (Rule 25(c) substitution was appropriate where judgment debtor gratuitously transferred its assets to an *alter ego* corporation in fraudulent effort to escape liability); *Drier v. Tarpon Oil Co.*, 522 F.2d 199 (5th Cir. 1975) (corporate president personally liable for company securities violation based on federal statute); C. WRIGHT & A. MILLER & M. KANE, 7C FEDERAL PRACTICE & PROCEDURE, 1958 at 559-60 (2d ed. 1986).

In all cited cases, substitution of parties or successor liability was based on special facts such as disregard of corporate entities or gratuitous asset transfers to evade creditors (which facts are absent in our case). In no case did the courts hold that nonparties could be substituted for parties based on financing or control of the litigation.

[11] The circuit court's statement at A. 44 ("We recognize that a substitution decision is within the discretion of the district court but find that its legal analysis was erroneous.") suggests a mandatory substitution when control by a nonparty is present.

in *R. J. Engstrom Corp., supra, Gee, supra, Leannais, supra,* and with the long-established rule that mere acquisition of a corporation's assets does not make the acquirer liable for its debts.

C. The First Circuit Misapplies a Procedural Substitution Rule (Civil Rule 25(c)) by Using It to Impose Substantive Liability on Any Parent Corporation That Finances or Controls Litigation of its Subsidiary.

Rule 25(c), Fed. R. Civ. P., is procedural only and does not affect the substantive rights of the parties which are determined by state law. E.g., *In the Matter of Covington Grain Co.*, 638 F.2d 1357, 1361 (5th Cir. 1981); *General Battery Corp. v. Globe-Union, Inc.*, 100 F.R.D. 252, 261 (D.C. Del. 1982). Because Explosives Corporation, Excoa, and Rockcor were all incorporated in Washington, its laws govern their capacity to sue or be sued. Rule 17(b), Fed. R. Civ. P.

The applicable Washington statute, RCW 23A.28.250, pertinently provides:

> Any such action or proceeding by or against the [dissolved] corporation may be prosecuted or defended by the corporation in its corporate name. The shareholders, directors, and officers shall have power to take such corporate or other action as shall be appropriate to protect such remedy, right, or claim.

The trial court thus found that Rockcor was entitled to finance the lawsuit in Explo's name without assuming any direct liability to Garlam:

> Having acquired all of Excoa's interest in this action Rockcor, as sole stockholder of a dissolved corporation, *could, however, assume the costs and control of the litigation* in order to protect Excoa's interest. See RCWA 23A.28.250.

(Emphasis added; A. 293-94). In other words, Rockcor had express statutory authority to carry on litigation in the name of its dissolved subsidiaries, and no cited case has previously held that the exercise of this right requires substitution for the judgment debtor under Rule 25(c), Fed. R. Civ. P.

Notwithstanding, the First Circuit substituted Rockcor as judgment debtor precisely on the ground that it had financed and controlled the litigation! The result is to transform Rule 25(c) from one of procedure into one substantively imposing successor liability upon any parent corporation financing and/or controlling litigation of an insolvent subsidiary. As now developed, the inequitable consequences of such a new interpretation are substantial.

D. The First Circuit's Opinion Improperly Penalizes Recourse to the Courts and Prosecution of Claims for the Benefit of Creditors of Insolvent Parties.

The circuit court's error is illustrated by considering its logical implications for the shareholders and creditors of corporate litigants. If participation in the lawsuit rendered Rockcor liable for Explo's debts to Garlam, then any corporate officer or shareholder risks personal liability by participating in its company's litigation. Banks who take security in their borrowers' legal claims would risk assuming liability for potential counterclaims against the borrowers. Insurers who participate in the defense of their insureds would be subject to liability in excess of policy limits (even as the circuit court has imposed liability exceeding the bond amount that Rockcor guaranteed). Defending its reasoning as a "two-way street" (A. 60), the Court in fact deviates from a well-worn path of established jurisprudence.

None of the cited cases hold that a nonparty who finances litigation is thereby liable for damages assessed against the assisted party. No case allows substitution of a nonparty under Rule 25(c), Fed. R. Civ. P., based on financing or control

of litigation. Participating nonparties may be "bound" by collateral estoppel, but they do not thereby become liable for damages awarded among the parties. If the circuit court's decision stands, it will effectively bar corporate creditors, officers, shareholders, and maybe even lawyers, from assisting their companies in litigation, for fear of incurring personal liability if there is an adverse money judgment.

2. Charging Explo with Costs of Work Beyond the Scope of Its Subcontract Conflicts With Decisions of this Court, and of Other Circuit Courts, and Represents a Departure from the Accepted and Usual Course of Judicial Proceedings.

As already developed, Explo subcontracted to blast between 1,509,000 and 2,000,000 cubic meters of rock, over a period of 600 days, for $0.51 per cubic meter. Following its default, it was charged with the cost of blasting almost twice as much rock, over a period three times longer, but with no credit for a unit price increase.

On two grounds, review is appropriate. First, the damage award is inconsistent with decisions of the Supreme Court and of other circuits holding that a terminated contractor may not be charged with costs of completing work that differs materially (in terms, conditions, or quantity) from the terminated contract. *E.g., United States v. Axman*, 234 U.S. 36, 42-43 (1913); *United States v. California Bridge & Construction Co.*, 245 U.S. 337, 344-345 (1917); *American Surety Co. v. United States*, 317 F.2d 652, 656-657 (8th Cir. 1963); *Steffen v. United States*, 213 F.2d 12 266, 271-272 (6th Cir. 1954);[12]

[12] These cases arise in the context of federal procurement law, which is largely the fount of construction law in the United States. They are strictly analogous because they well illustrate the common law damage measure in cases where contractors do not complete performance, which is limited by "the reasonable

(see next page)

see also McBRIDE & TOUHEY, GOVERNMENT CONTRACTS, § 33.80 at 33-107 (1984 ed.) ("Should there be a material variation between the original contract and the relet contract, the liability of the defaulted contractor for excess costs is discharged or extinguished. Anything in the relet contract which causes a substantial increase in price is a material variation.").

Second, the circuit court departs from the accepted and usual course of judicial proceedings by refusing to enforce or even recognize a subcontract term that was expressly incorporated by reference from Garlam's prime contract (A. 16). This clause guaranteed a renegotiated unit price for any work that overran by more than 25 percent "in dollars or in extent." *See* note 5, *supra* at p.6.

With respect, we submit that the circuit court's objectively inaccurate denial represents an unacceptable departure from the accepted and usual course of judicial proceedings.

CONCLUSION

The writ should be granted because this petition raises an important question concerning the proper application of the Federal Rules of Civil Procedure, for which this Court has ultimate responsibility.

The circuit court's unique interpretation of Rule 25(c), Fed. R. Civ. P., presents this Court with an issue of first impression. To our knowledge, never before has any circuit (or district) court held that control and management of an insolvent subsidiary's litigation constitutes a sufficient

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(continued from previous page)

cost of construction and completion *in accordance with the contract*" (emphasis added) (RESTATEMENT OF CONTRACTS, 346 (1932)).

"transfer of interest" under Rule 25(c) so as to substitute the parent as liable party for an adverse award. The circuit court's new standard for Rule 25(c) substitution conflicts with both decisions of this and other circuit courts, and with the long established rule that a transferee of corporate assets does not assume liability for the transferor's debts.

Perhaps most significantly, the circuit court's new substitution standard would punish creditors, shareholders, officers, and maybe even lawyers, who control or defend an insolvent subsidiary in litigation, with personal liability for an adverse judgment. Such an unprecedented and inequitable restriction upon access to the federal courts and prosecution of claims therein deserves review by this Court.

This Court is also asked to review the decision that Explo should receive credit for no more than its subcontract unit price, even for quantities and duration of work far beyond its original agreement. As developed above, and to be blunt, the circuit court was just plain wrong. Review is justified because that error conflicts with unchallenged decisions of this Court and of other circuits, and represents a departure from the accepted and usual course of judicial proceedings.

DATED this 31st day of July, 1987.

Respectfully submitted,

STUART G. OLES
Counsel of Record, and
ARTHUR D. McGARRY
DOUGLAS S. OLES
OLES, MORRISON, RINKER,
STANISLAW & ASHBAUGH

SALVADOR ANTONETTI
FIDDLER, GONZALEZ & RODRIGUEZ
Counsel for Petitioners

UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

No. 86-1303

EXPLOSIVES CORPORATION OF AMERICA,
et al.,
Plaintiffs, Appellants,

v.

GARLAM ENTERPRISES CORPORATION,
et al.,
Defendants, Appellees.

No. 86-1362

EXPLOSIVES CORPORATION OF AMERICA,
Plaintiffs, Appellees,

v.

GARLAM ENTERPRISES CORPROATION,
Defendant, Appellant.

No. 86-1650

EXPLOSIVES CORPORATION OF AMERICA,
et al.,
Plaintiffs, Appellants,

v.

GARLAM ENTERPRISES CORPORATION,
et al.,
Defendants, Appellees.

APPEALS FROM THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF PUERTO RICO

[Hon. W.A. Bootle,* Senior U.S. District Judge]

[Hon. Carmen C. Cerezo, U.S. District Judge]

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* Of the Middle District of Georgia, sitting by designation.

BOWNES, Circuit Judge. This appeal stems from a contract between Garlam Enterprises Corporation (Garlam) and Explosives Corporation of America (Explo). On January 3, 1972, Explo sued Garlam for breach of contract. Garlam filed an answer and brought a counter-claim alleging breach of contract by Explo. After two jury-waived trials, one on liability and one on damages, Explo was found liable to Garlam in the amount

of $2,423,177.[1] Explo has appealed the liability finding, the damages award, and the award of post-judgment interest. It also claims that the adjudications made by the Superior Court of Puerto Rico in a suit brought by Garlam against the Puerto Rico Highway Authority were binding on Garlam and the district court and require a reversal of the judgment. Garlam has appealed from a denial of its motion to substitute Rockor, Inc., for Explo as the defendant-appellant in the contract action. Garlam also appeals the district court's refusal to award it attorney's fees, costs and prejudgment interest.

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[1] Judge Bootle heard and decided the liability phase of the case. Judge Cerezo has decided all of the other issues.

I. CONTRACT LIABILITY

A. The Findings and Evidence

The district court made extensive and detailed findings of fact which we have reviewed pursuant to the command of Federal Rule of Civil Procedure 52: "Findings of fact, whether based on oral or documentary evidence, shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses." Based on our examination of the trial transcript, depositions and exhibits, we conclude that the district court did not make any clearly erroneous findings of fact. Our summary of the evidence and findings follows.

Garlam was the successful low bidder for the construction of one section of a highway in Puerto Rico running from San

Juan to Ponce. It entered into a contract with the Puerto Rico Highway Authority to do the work for an estimated total price of $13,489,412.39. The contract was advertised and bid as a series of forty-one different work items. Garlam submitted a separate bid price for each. Garlam's total bid was calculated by multiplying each work unit price by the estimated quantities of work to be done and then adding up the amounts for each of the forty-one work items. The estimated quantities of work were supplied by the Highway Authority.

Two work items are of special significance. Item 4, entitled Unclassified Excavations, required, inter alia, the mass blasting of rock wherever found. Garlam's bid was $2.03 per cubic meter on an estimated quantity of 4,680,000 cubic meters of material to be excavated.

Garlam had to excavate the material from the job site and deposit it in designated embankment areas as fill. Item 35 covered presplitting, which is a procedure for limiting the effects of rock blasting to a restricted area. Garlam's bid price for this work was $1.40 per lineal foot on an estimated quantity of 300,000 lineal feet; the total bid price was $420,000.

After a period of negotiations between Raymond Garffer, president of Garlam, John W. Goode, division general manager for Explo, and Hugh E. Oswald, general counsel for Explo, a contract was executed on April 28, 1971. An amendment to the contract executed May 5, 1971, stated that Explo would begin work "on May 12, 1971, for a total of four hundred eighty-nine (489) calendar days and shall terminate said work September 22, 1972."

The contract stated that "time was of the essence."

The contract provided that Explo would perform all the mass blasting necessary under Item 4 of the prime contract between Garlam and the Highway Authority at a unit price of .51 cents per cubic meter of material. Explo also agreed to do the presplitting required under Item 35 of the prime contract at the rate of .70 cents per lineal foot. The unit price clause of the contract contained the following provision: "Blasted rock fragments shall average up to a maximum of 15 inches in size." This language was the result of negotiations between Garffer, Goode and Oswald. The words "up to a maximum" were inserted at the insistence of Garffer; the word "average" came from Goode. Oswald drafted the composite clause. Garffer testified that he

expected that ninety to ninety-five percent of the blasted material would be less than fifteen inches in size. He acknowledged that inevitably some large boulders would be produced, but anticipated that they would be reduced in size bv secondary blasting. Garffer also testified that when he first met with Albert Teller and John Goode, who were in charge of Explo's field operations in Puerto Rico, he asked them if they could give him an average product four to six inches in size and they assured him that they could.

Immediately after the contract was executed on April 28, 1971, Garlam instructed Explo to begin blasting. Explo, however, did not start until early in June. After the first few blasting shots, Garlam informed Explo that the rock fragments were too large and con-

trary to the contract specifications. Explo did not challenge Garlam's interpretation of the contract until September 22, 1971, when it stated in a letter to Garlam that the rock-size clause meant "an average maximum" of fifteen inches.

Explo had blasted very little rock of any size by September of 1971 and had received no payments from Garlam for what blasting it had done. Explo retained the law firm of DeGarmo, Liedy [sic], Oles and Morrison of Seattle. They contracted for the services of Arner [sic] W. Erickson, a civil engineer, who had considerable experience in highway construction and blasting operations. Erickson came to Puerto Rico on September 5, 1971, to investigate the

situation. He met with Garffer of Garlam the next day and inspected the job site.

Erickson's testimony included statements to the following effect: He did not attempt to resolve the controversy over the rock size. He saw blasted rocks ranging in size from six and seven feet down to one foot. Garlam had good reasons for wanting rocks less than fifteen inches in size; the blasted material would be easier to handle and move and it was more suitable for use as fill in the embankment. Large boulders could not be used for fill.

Erickson returned to Seattle before September 11. He advised Explo to replace some of its personnel in Puerto Rico and to increase the amount of equipment it was using. Explo replaced the two men in Puerto Rico in charge of its operations, Teller and Goode, with

Messrs. Cronin and Herrera. Cronin and Herrera arrived sometime in late September. Beginning in October, the quantity and quality of the blasting material produced by Explo improved. Garlam had continuously insisted that the rock blasted should not exceed fifteen inches in size, but Explo regularly and consistently exceeded that size.

In the morning of November 3, 1971, Garffer met with Attorney Oles and W.E. Johnson of Explo. Johnson had been hired by Explo to manage all its Puerto Rico jobs[2/] from October of 1971 to March, 1972. Oles informed Garffer that, unless its price for mass blasting was raised to .82 cents per cubic yard and its presplitting increased by some negotiated amount, Explo would be forced to leave

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2/ Explo had two other jobs in Puerto Rico in addition to the one for Garlam.

the project. Garffer told them that he would think it over and give them his decision that afternoon. Garffer told Oles and Johnson in the afternoon of November 3 that he would not renegotiate the contract prices. Oles then informed Garffer orally that Explo terminated the contract. This oral termination was confirmed in a letter dated November 9.

The reason advanced by Explo for its slow progress on the job was that Garlam had no available written work schedule and that Explo, therefore, was unable to properly program its blasting activities. Garlam followed the critical path method in scheduling its work. It provided the Highway Authority with its work schedules, which under the prime contract had to be programmed on a weekly and daily schedule. Copies of the critical path schedules were available to Explo in

Garlam's construction-site office. One of Garlam's supervisors met daily with Explo and advised it of the work schedule. Explo was also advised of the weekly work schedule that Garlam was following.

Under the contract, there were to be partial payments to Explo for its production at the agreed unit price within ten days after Garlam had been paid by the Highway Authority for that particular work. Garlam made no payments to Explo, although it had received payments from the Highway Authority for work done by Explo. Garlam made no payments to Explo for two reasons. First, it felt that payment was not warranted because of the great number of rocks in excess of fifteen inches. In connection with this, there was some discussion of reducing the payments by fifty percent because of the

oversized blasted fragments, but no agreement was reached. The second reason for Garlam's failure to make any payments was that Explo owed it money for the use of Garlam's equipment, personnel, and other services. The amount due Garlam from Explo was greater than any payments due Explo for blasting.

The critical findings of the district court can be stated as follows. Explo "passively" accepted Garlam's interpretation of the rock-size clause in the contract until September 22, 1971. The clause was a composite drafting by both Explo and Garlam with the final language drafted by Attorney Oswald of Explo. "During the six months period that Explo was working on the project, it did not comply with the interpretation of Garlam as to the maximum rock size although Garlam continuously insisted that Explo

produce material not exceeding 15 inches in size."

Despite the contract provisions and Garlam's instructions, Explo unnecessarily delayed starting its work and continued to show slow progress in carrying out the blasting. Explo's slowness was not attributable to Garlam which had the right under the contract "to direct the work of Explo from day to day and coordinate Explo's work with its own and that of other subcontractors."

Explo abandoned the contract on November 3, 1971.

B. Conclusions of Law of the District Court

We turn next to the pertinent conclusions of law of the district court. The conclusions are indented and followed by our comments.

A. The contract is to be interpreted under Puerto Rico law. There is no dispute as to this.

B. Explo was not a third-party beneficiary of the prime contract and "any alleged violations of the prime contract by Garlam would not justify Explo's failure to perform the subcontract or its abandonment of the project."

Explo seems to argue that it had a right of renegotiation because the prime contract provided for equitable renegotiation of unit prices if the actual work quantities differed substantially from the Highway Authority's estimate. There was, however, no such provision in Explo's contract and the district court's ruling was correct. Moreover, there was no evidence before the district court that Explo's production was affected in any way by the work

quantity estimates of the Highway Authority. The difficulties between Explo and Garlam stemmed from three factors: oversize rock fragments, low quantity of material blasted, and slow work progress.

> C. The subcontract between the parties does not have a termination or rescission clause that will permit Explo to rescind or cancel the subcontract with Garlam . . . . If Explo is entitled to terminate the agreement . . . the authorization to do so is to be found not in the subcontract but in some other source.

This is a correct reading of the contract.

> D. It is not necessary to decide whether under Puerto Rico law substantial nonpayment excuses performance because "the evidence fails to establish any substantial non-payment."

This finding of fact is not clearly erroneous.

> F. The language contained in the unit price clause is ambiguous and therefore it is necessary to apply the rules of interpretation contained in the Civil Code of Puerto Rico. Title 31 § 3478 of that code reads as follows:
>
> > The interpretation of obscure stipulations of a contract must not favor the party occasioning the obscurity.
>
> The language of the unit price clause was finally drafted by Mr. Hugo E. Oswald, Jr., then general counsel for Explo, in the negotiations of the subcontract. While both Garlam and Explo contributed some of the complicating words, the final drafting was actually done by Mr. Oswald. We conclude as a matter of law that the obscurity of the language must be charged to Explo and that the correct interpretation of the unit price clause is that the material to be produced must be generally within the range of 15 inches or less. We conclude that otherwise Garlam could not comply with other requirements of the prime contract which required it to dispose of the

> rock fragments to construct compaction layers of approximately 6 inches in the embankments and 24 inches in the rock fills. The interpretation of the clause suggested by Explo creates an absurd situation which this court rejects. Its suggested interpretation is inconsistent with its explicit contractual obligation to blast "secondary boulders that may appear after a blasting operation, if required by the contractor." Therefore, in the determination of the amount of work done by Explo, consideration should be given to the contractual requirement that Explo produce material which finally could not exceed 15 inches as a maximum size and that such other larger boulders had to be broken down by secondary blasting if they exceeded this maximum of 15 inches.

Explo objects strenuously to this mixed finding of law and fact. Whether the "obscurity" of the language should be charged to Explo is a close question, but we think that Oswald, as a lawyer, should have been aware that the rock-size clause was ambiguous and thus we agree with the

district court that the responsibility for its language lay with him. Even, however, if we accept the clause as a joint production, the evidence establishes that Explo knew and understood that rocks in excess of fifteen inches were to be the exception rather than the rule from the time the contract was being negotiated to its dissolution by Explo on November 3, 1971. Explo's field managers, Teller and Goode, told Garffer during contract negotiations that Explo could produce rocks averaging four to six inches in size. Explo did not urge its version of the meaning of the clause until September 22, 1971. And, after the new personnel arrived on the job in October, the size of the rock fragments diminished appreciably. We interpret the contract provision as did the district court.

> G. As a consequence of this breach by Explo, Explo is obligated to pay to Garlam the actual and necessary additional costs reasonably incurred by Garlam in order to complete the work required by Explo by the subcontract. As above indicated, the question whether or not any delay penalty is chargeable against Explo and if so, how much, is to be determined by evidence adduced in the second trial. The question of interest on any amounts credited to or chargeable against Explo is likewise to be determined by evidence adduced at the second trial. All costs of this first trial are taxed against Explo.

This ruling follows logically from the previous ones.

II. DAMAGES

By stipulation of the parties, the damages issue was referred to a master. The master held a two-day hearing at which a great number of exhibits of considerable size and complexity were introduced. His detailed and extensive

report was issued about six months after the hearing.[3] The master awarded damages to Garlam in the amount of $2,423,177. The findings and rulings of the master were subsequently adopted by the district court.

We agree with the district court that the master applied the correct legal principles in making his findings, which were supported by the evidence and not clearly erroneous. We rule specifically that Garlam carried its burden of proof on damages. There is no basis in the contract or the evidence for finding that Explo was entitled to an equitable price increase. Nor are we impressed with Explo's argument that Garlam failed to

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3/ The master actually rendered two reports: a preliminary draft dated March 19, 1980, submitted to the parties for their comments and recommendations; and a final report dated April 24 and filed on April 29, 1980.

mitigate its damages and, hence, is precluded from recovering. This overlooks the fact that, after Explo breached its contract, Garlam was under time constraints in its prime contract with the Highway Authority to complete the blasting within a comparatively short time.[4/] The measure of damages was, as the district court found, "the actual and necessary additional costs reasonably incurred by Garlam in order to complete the work required by Explo by the subcontract." The amount arrived at by the master reflected accurately the application of this damages formula.

4/ Explo had agreed to do the work by September 22, 1972.

III. THE SUIT IN PUERTO RICO SUPERIOR COURT BY GARLAM AGAINST THE HIGHWAY AUTHORITY

We now turn to Explo's claim that the adjudications in Garlam's Puerto Rico Superior Court suit against the Highway Authority were binding on Garlam and the district court and require a reversal of the judgment against Explo.

Initially we note that we can find nothing in the record to indicate whether the Superior Court judgment, which is dated June 15, 1982, has been appealed. Nor have we found any definitive record of when the Superior Court action was commenced. We will, however, for purposes of our analysis accept Explo's representation that the suit was filed prior to the start of the hearing on damages before the master.

We agree with Explo that a judgment of the Commonwealth court is entitled to full faith and credit by a federal court. We also agree that the collateral estoppel doctrine of issue preclusion would prevent a party from denying or relitigating in federal court issues already decided by the Superior Court of Puerto Rico. The question is whether, under the circumstances here, the rulings and findings of the Superior Court in the case of Garlam v. The Highway Authority require a reversal of the judgment in this case. We find that they do not for several reasons.

The first is a matter of chronology. The Superior Court judgment did not issue until June 6, 1982. It, therefore, post-dated the liability verdict of March 30, 1977, in this case by more than five years. It also postdated the master's

report of April 29, 1980, by more than two years. And, although the Superior Court judgment did precede the opinion and judgment of the district court of November 16, 1982, adopting the master's findings and rulings, the Superior Court judgment was not called to the district court's attention until November 24, 1982.

Under this chronology, we rule that the Superior Court judgment could have no effect on the liability rulings and findings made in this case. We agree with the district court that Explo's tardy invocation of the Superior Court judgment precludes it from using the judgment for an attack on the damages awarded Garlam. Explo knew about the Superior Court action from at least the date of the hearing before the master on damages, October 29-31, 1979. It questioned and

cross-examined Highway Authority witnesses about the Commonwealth court action, referred to the pleadings, and introduced in evidence part of the proceedings in the Superior Court. It is fair to assume that Explo followed the progress of the Superior Court action closely. We think it was inexcusable for Explo to wait until after the district court's opinion and judgment on damages before raising the issue of the effect of the Superior Court case on this litigation. The doctrine of laches applies to such conduct.

We are also troubled by Explo's failure to at least attempt to intervene in the Superior Court action. The comments of the district court are pertinent:

> Explo has not explained either why it never sought intervention in the Commonwealth case or why it did not request joinder of the

> claim against Garlam for the equitable unit price reduction it could have allegedly derived from Garlam's contract with the PRHA. The record shows that the Superior Court case was known and monitored by Explo throughout the years. Explo continuously referred to the pleadings filed in that case and even submitted part of the Superior Court's record as evidence for the Special Master to consider in his determination of damages. Explo's argument that it was not necessary for it to intervene in the Superior Court action because that case dealt with other matters is self-defeating. The Puerto Rico Rules of Civil Procedure allowed Explo to appear in that action to plead precisely the third-party beneficiary status theory that it has now attempted to introduce in this case. Likewise, it could have joined as a party in the two actions. Instead, it adopted a wait and see attitude and never formally raised this new theory of equitable price reduction in this litigation or in the one before the Superior Court.

In addition to the procedural barriers to Explo's attempt to use the Superior Court case to avoid the judgment

against it, there are also substantive grounds precluding the application of the doctrine of issue preclusion. We note first that the findings and rulings of the Superior Court do not discuss blasting or Explo's role in the highway construction. The Superior Court found that the Highway Authority owed Garlam $2,466,316.73 based upon the following specific findings:

a) Deposit of 385,803.71 cubic meters of borrowed material agreed upon at $2.95 per cubic meter (Finding of Fact No. 3) $1,138,120.94

b) Difference owed on over-cuts and miscellaneous cuts -328,008.20 cubic meters at $.92- (Finding of Fact No. 4) 294,407.54

c) Asphalt provided - 553.645 tons at $25.88 (Fact No. 5) 46,305.57

d) Compacted material - 2,196,093.62 cubic meters at $.30, less $7,274.43 granted by summary judg-

	ment of March 12/78 (Fact No. 6)	651,553.66
e)	Excavation of material for benchings 137,794.92 cubic meters at $2.03 - (Fact No. 7)	279,722.67
f)	Commercial profit and administrative expenses on work performed through force account (Fact No. 8)	56,206.35
	Total to be paid	$2,466,316.73

Explo's argument can best be stated in its own words:

> In Superior Court, Garlam blamed the owner for cost overruns and collected millions of dollars based (in part) on faulty design. Meanwhile, in federal court, Garlam charged Explo for the entire cost overrun on rock blasting and denied that design errors existed. Garlam refused to credit Explo with the same kind of equitable price adjustment which Garlam obtained for part of its own work from the owner. In short, Garlam wants Explo to reimburse costs which the Superior Court has attributed to the Highway Authority.

Explo's Brief for Nos. 1303 and 1650 at 46. This is a misreading of both the Superior Court decision and the master's findings and rulings on damages. The Superior Court based its decision on the prime contract between the Highway Authority and Garlam in light of subsequent events that related to those two parties alone: the Highway Authority's issuing of thirty extra work orders and nine change orders; its failure to pay Garlam the agreed price for excavating, moving, and depositing of borrowed material; and its failure to pay Garlam anything for certain work items performed. The basis of the master's decision on damages was the extra cost incurred by Garlam due to Explo's breach of its blasting contract. These were two separate lawsuits and the issues in both were different. In short, there can be

no issue preclusion because there is no identity of issues in the two cases.

In this connection, we point out that if Garlam were recovering twice for the same items of work, it would have been to the Highway Authority's advantage to invoke the doctrine of collateral estoppel as to those items for which Garlam was seeking recovery against both Explo in federal court and the Highway Authority in the Superior Court. The Highway Authority was fully aware of the suit by Explo and Garlam's counterclaim. The Authority's resident engineer testified at the federal trial on liability and the general counsel for the Department of Public Works testified at the federal trial on damages and introduced excerpts from the Superior Court trial. Although the Highway Authority

might possibly have overlooked some double pay items, it does not seem likely.

For all the foregoing reasons, we rule that the doctrine of collateral estoppel cannot be invoked in this case and that the rulings and findings of the Superior Court case have no effect on the judgment rendered in the case before us.

IV. INTEREST COMPUTATION

On May 19, 1986, the district court ordered that interest on damages be computed pursuant to 28 U.S.C. § 1961 from November 16, 1982, the date of the court's judgment awarding damages to Garlam. Explo appeals the date of interest accrual, arguing that interest should only be awarded from March 6, 1986, the date of the district court's judgment after which these appeals were filed.

A. Procedural History

The case was brought in the United States District Court on January 3, 1972. On November 28, 1979, Garlam appealed from the dismissal of its third-party complaint against Rockor. On December 10, 1979, this court stated: "Since it does not appear on the papers before us that the district court certified this dismissal as final pursuant to Rule 54(b) of the Federal Rules of Civil Procedure, we lack jurisdiction over this appeal." On November 16, 1982, the district court entered a judgment against Explo on its complaint and for Garlam on its counterclaim. On March 15, 1983, Explo filed a notice of appeal. On May 9, 1983, this court dismissed the appeal holding: "It appearing that the notice of appeal was filed while a motion to substitute parties was pending, we

view the judgment below as not a final judgment." On August 16, 1985, Garlam filed a notice of appeal from the judgment of November 16, 1982,[5] and the district court's order of August 8, 1975, denying Garlam's motion to substitute Rockor for Explo. On August 26, 1985, the district court granted Explo's motion to have the proceedings continue in that court because Explo had a pending motion for postjudgment relief. On October 10, 1985, this court dismissed Garlam's appeal. The memorandum and order reads:

> In 1983, Garlam Enterprises Corporation ("Garlam") argued to this court that an order entered by the district court in November, 1982, was not a final order because it did not adjudicate all of the claims against all of the parties. This court agreed, noted that

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5/ Garlam appealed from the denial of prejudgment interest, costs and attorney's fees, and the order to pay one-half of the master's fees.

against all of the parties. This court agreed, noted that proceedings were still pending in the district courts [sic], and dismissed without prejudice an appeal filed by Explosives Corporation of America ("Explo").

Now, Garlam argues to this court that the November 1982 order was a final judgment, and that a Motion for Reconsideration filed recently by Explo is therefore untimely. This court's prior order, however, reflects the law of the case and is binding precedent upon Garlam at this stage of the litigation. United States v. DeJesus, 752 F.2d 640, 642 (1st Cir. 1985) (per curiam).

Alternatively, Garlam requests that this court take jurisdiction over this appeal even though a motion for post-judgment relief is pending in the district court. We decline to do so for two reasons. First, it appears that no final judgment has been entered in this matter. Adjudication of Garlam's motion for substitution of parties in and of itself does not constitute entry of a final judgment. See Fed.R.Civ.P. 58.1/ Second, the instant notice of appeal is, in any event, premature because of Explo's pending motion for

> post-judgment relief. That motion tolls the running of the appeal period. F.R.A.P. 4(a)(4). The district court explained this to Garlam, and informed Garlam that it should file a new notice of appeal after that court ruled on Explo's motion.
>
> The appeal is dismissed for lack of jurisdiction, without prejudice to timely filing of new notices of appeal. [Emphasis added.]

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1. We draw this to the attention of the parties and the district court so that this matter can be clarified or corrected without causing the parties further unnecessary delay.

On March 6, 1986, the district court entered an order that was "[f]or purposes of an appeal . . . a Final Judgment." On March 24, 1986, Explo filed a notice of appeal, and on March 31, 1986, Garlam followed suit. It is from these notices that the current appeals stem.

On May 19, 1986, the district court decided that interest should run from the date of its judgment issued November 16, 1982. It based its ruling on the fact that using the date of its March 6, 1986, judgment would "deprive Garlam of its statutory right to obtain interest on the November 16, 1982, judgment [and] would defeat the purposes of [28 U.S.C.] section 1961." The court stated that it had followed the requirements of Rules 58 and 79(a) of the Federal Rules of Civil Procedure for making its November 16, 1982, judgment final with respect to interest accruing, even if the same judgment was not "final" for the purposes of appeal.

B. The Date for Accruing Interest

"Interest shall be allowed on any money judgment in a civil case recovered in a district court. . . . Such inter-

est shall be calculated from the date of the entry of the judgment." 28 U.S.C. § 1961 (Supp. 1987) (emphasis added).

A judgment "includes a decree and any order from which an appeal lies." Fed. R. Civ. P. 54(a). It is clear from this court's prior dismissals that the November 1982 judgment was not final because other issues remained to be resolved.

The district court never made a Rule 54(b)[6] determination as to the November

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6/ Federal Rule of Civil Procedure 54(b) provides:

(b) Judgment Upon Multiple Claims or Involving Multiple Parties. When more than one claim for relief is presented in an action, whether as a claim, counterclaim, cross-claim, or third-party claim, or when multiple parties are involved, the court may direct the entry of a final judgment as to one or more but fewer than all of the claims or parties only upon an express determination that there is no just reason for delay

(See next page.)

1982, judgment nor did Garlam ask for one. Moreover, the district court's order of August 8, 1985--allowing the proceedings to continue in that court despite a pending notice of appeal--suggests that the judgment of November 16, 1982, was not intended to be final.

There is merit to the district court's opinion on interest and there is precedent for awarding interest from the date of judgment on liability and damages. See Turner v. Japan Lines, Ltd.,

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(Continued from previous page.)

and upon an express direction for the entry of judgment. In the absence of such determination and direction, any order or other form of decision, however designated, which adjudicates fewer than all the claims or the rights and liabilities of fewer than all the parties shall not terminate the action as to any of the claims or parties, and the order or other form of decision is subject to revision at any time before the entry of judgment adjudicating all the claims and the rights and liabilities of all the parties.

702 F.2d 752 (9th Cir. 1983), which held that interest should be computed from the initial assessment of damages where there was a delay between that date and the date of entry of final judgment. Turner expressly rejected the holding in Hooks v. Washington Sheraton Corp., 642 F.2d 614, 616 (D.C. Cir. 1980), which confined the application of 28 U.S.C. § 1961 to a final judgment as defined in Rule 54(b). For several reasons, we believe it would be inappropriate to allow postjudgment interest to begin running before entry of final judgment in this case.

First, Garlam never sought a Rule 54(b) determination even though it had been alerted to the problem by our order of December 10, 1979. Second, Garlam argued that the November 16, 1982, judgment was not final when Explo attempted to appeal the liability part of the judg-

ment. If the judgment was not final for liability purposes, it could not be final on damages. Third, we dismissed appeals on December 10, 1979, May 9, 1983, and October 10, 1985, on the same grounds: that there was no final judgment from which an appeal could be taken. We do not deem it advisable at this stage of the proceedings to decide that final judgment meant one thing for appeal and another for the computation of interest. It is, of course, not without significance that the district court failed to make a Rule 54(b) determination as to its judgment of November 16, 1982.

For the foregoing reasons, interest pursuant to 28 U.S.C. § 1961 must be recomputed starting March 6, 1986.

V. THE SUBSTITUTION ISSUE

Garlam appeals the denial of its motion to amend the pleadings so as to add Rockor, Inc. (Rockor), as a defendant to its counterclaim and the denial of its motion to substitute Rockor for Explo. Since we conclude that substitution should have been allowed, we focus on that.

Federal Rule of Civil Procedure 25(c) provides in pertinent part:

> **(c) Transfer of Interest.** In case of any transfer of interest, the action may be continued by or against the original party, unless the court upon motion directs the person to whom the interest is transferred to be substituted in the action or joined with the original party.

The basic question is whether Rockor should be held liable for the damages awarded Garlam against Explo. Despite the fact that Explo's interest in the

lawsuit was transferred to Rockor, the district court decided against substitution on the ground that liability should not be imposed on Rockor for the debts of its predecessor. We recognize that a substitution decision is within the discretion of the district court but find that its legal analysis was erroneous.

The resolution of this issue turns on the relationship between Rockor, Explo, and Excoa, a corporation with which Explo merged, and Rockor's role in the litigation. The record on this issue consists of stipulated exhibits and the deposition of George S. Sutherland, chairman of the board of Rockor. There is no dispute over the facts, only the conclusions to be drawn from them. In 1959, Rocket

Research Corporation (Rockor)7/ was incorporated in the State of Washington for the research, development, and manufacture of rocket engines and propellants. Sutherland started working for Rockor in 1960 and became its chief executive officer. In May 1966, Explosives Corporation of America (Explo) was incorporated to research, develop, and manufacture explosives. Rockor was Explo's sole stockholder; it owed [sic] 92% of the stock. Sutherland became chairman of the board of Explo. One of Explo's requirements under its contract with Garlam was that it obtain a surety and performance bond in the amount of 1.2 million dollars. The bond was obtained from the General Insurance Company of

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7/ On March 15, 1977, Rocket Research Corporation changed its name to Rockor, Inc.

America after Rockor agreed to indemnify the bonding company if Explo failed to perform. Rockor had full knowledge of the lawsuit since it started; it filed yearly status reports on the litigation with the S.E.C.

In early 1973, Excoa, Inc., was incorporated for manufacturing explosives and chemicals. Rockor was the sole stockholder and owner of Excoa and Sutherland was chairman of Excoa's board of directors from its formation until its dissolution. Explo was merged into Excoa on April 27, 1973, with Excoa assuming all of Explo's debts and liabilities. One of the purposes of the merger was to increase Rockor's ownership of Explo's stock from 92% to 100%. On October 29, 1976, Rockor, as the principal creditor of Excoa, took over most of Excoa's assets; Excoa owed Rockor approximately

$5,600,000. The bill of sale from Excoa to Rockor included all of Excoa's interest in the lawsuit between Explo and Garlam. There was no limitation on the extent of Rockor's participation in the lawsuit. Excoa was subsequently dissolved for tax purposes and not for any reason connected with the litigation. Attorney Oles has represented Explo, Excoa, Rockor, and the General Insurance Company (bonding company) since the start of the lawsuit. Since at least 1976, Rockor has financed the litigation directly.

It can be fairly inferred from the foregoing facts that Rockor has controlled the litigation at least since it took over Excoa's assets on October 29, 1976.

The pertinent procedural history of the substitution issue must also be

recounted. On September 9, 1977, after the liability judgment but before the hearing and award in damages, Garlam moved to substitute Rockor for Explo. This motion was never ruled on directly. Apparently at the suggestion of the court, Garlam filed a motion on November 10, 1977, asking that Rockor be added as a defendant to the counterclaim. On November 6, 1982, former Chief Judge Pesquera reversed a prior ruling he had made and denied the motion for lack of in personam jurisdiction over Rockor. Judge Cerezo reaffirmed the jurisdictional dismissal of Rockor as an additional party but stated that she would consider a motion for substitution under Federal Rule of Civil Procedure 25(c). Such a motion was filed by Garlam on December 15, 1982. On August 7, 1985,

the district court denied the motion to substitute Rockor for Explo.

The district court's opinion focuses on the fact that Rockor was a separate entity from Explo-Excoa and that Rockor did not assume Explo-Excoa's liabilities. The cases on which it relied involved the question of whether a successor corporation could be sued in the first instance and held liable for the acts or failure to act of its predecessor. With due respect, we think that the court's focus was misdirected; it should have been on the relationship between Rockor and Explo-Excoa and the role Rockor played in the litigation.

In Montana v. United States, 440 U.S. 147 (1979), the Court discussed the effect of the related doctrines of collateral estoppel and res judicata on a nonparty who controls the litigation. It

held that the interests advanced by these doctrines "are similarly implicated when nonparties assume control over litigation in which they have a direct financial or proprietary interest and then seek to redetermine issues previously resolved." Id. at 154. The Court then quoted Souffront v. Compagnie des Sucries, 217 U.S. 475, 486-87 (1910):

> "[One who prosecutes or defends a suit in the name of another to establish and protect his own right, or who assists in the prosecution or defense of an action in aid of some interest of his own . . . is as much bound . . . as he would be if he had been a party to the record."

We recently applied this principle to hold the two shareholders of a corporation, who were officers and members of the board of directors, liable for unpaid contributions of the corporation to an employee benefits plan. Alman v. Danin, 801 F.2d 1 (1st Cir. 1986). We stressed

that the individuals "held ultimate and complete control over the litigation strategy the now defunct corporation pursued" and that "both men had an economic stake in the outcome of the trial and were, of course, in a position to know everything that occurred." Id. at 5. Rockor was in essentially the same position vis-a-vis Explo-Excoa as were the two shareholders in Alman and, like them, had complete control over the litigation. We realize that in Alman the action was brought directly against the individuals and the question of substitution under Rule 25(c) was not involved.

The underlying legal principle that a participating nonparty is bound by the judgment does not, however, depend upon the procedural stance of the case. In Panther Pumps & Equipment Co., Inc. v. Hydrocraft, Inc., 566 F.2d 8 (7th Cir.

1977), cert. denied sub nom. Beck v. Morrison Pump Co., Inc., 435 U.S. 1013 (1978), the Court held that Rule 25(c) could be invoked to substitute a successor in interest who had obtained the assets of the corporation against whom judgment had been rendered. It defined successor as "one who succeeds or takes the place of another." Id. at 24. It quoted Moore's Federal Practice:

> Rule 25 has application only to actions pending in the district courts. But this should not preclude substitution after judgment has been rendered in the district court * * * for the purpose of subsequent proceedings to enforce * * * a judgment. [3B Moore's Federal Practice ¶ 25.03[1], at 25-101 (2d ed. 1977), footnote omitted]

Id. at 23. The facts in Minnesota Mining and Manufacturing Company v. Eco Chem, Inc., 757 F.2d 1256 (Fed. Cir. 1985), have some similarity to the facts in the instant case. Suit was brought by 3M

against Eco Chem, Inc., a corporation owned and controlled by Stephanie and George Rynne. A default judgment was obtained against Eco Chem. After suit had been commenced, the Rynnes formed a Georgia corporation, ECL, and the shareholders of Eco Chem exchanged their stock for ECL shares and all of Eco Chem's assets were transferred to ECL, making Eco Chem completely judgment proof. The court found that ECL was properly joined as a party "because it succeeded to the assets from which 3M may satisfy its judgment." Id. at 1264.

It has long been the rule that a nonparty who controls the litigation is bound by the judgment. "The reason would be that the non-party would have the power to determine what evidence and arguments should be offered in the litigation and, if appropriate, the appeal."

General Foods Corporation v. Massachusetts Department of Public Health, 648 F.2d 784, 789 (1st Cir. 1981). See also Drier v. Tarpon Oil Company, 522 F.2d 199 (5th Cir. 1975) (president of corporation held liable because of privity and as a controlling person under 15 U.S.C. § 77o [sic]); Kreager v. General Electric Company, 497 F.2d 468, 471 (2d Cir. [sic]) (sole shareholder of corporation bound by dismissal of first action brought in the name of his corporation), cert. denied, 419 U.S. 861 (1974); Pan American Match, Inc. v. Sears, Roebuck & Co., 454 F.2d 871, 874 (1st Cir. [sic]) (subsidiary corporation sufficiently identified with its parent company to represent the legal rights of the parent), cert. denied, 409 U.S. 892 (1972); 1B J. Moore, J. Lucas, & T. Currier, Moore's Federal Practice and

Procedure § 0.411[10] at 477-78 (1984 & Supp. 1986-87).

We agree with the district court that there is no problem of in personam jurisdiction. There are two reasons. First, once in personam jurisdiction has been found over the original party, it exists over the substituted party despite its lack of contacts with the forum if the substituted party had an opportunity to challenge its joinder or substitution. Minnesota Min. & Mfg. Co. v. Eco Chem, Inc., 757 F.2d at 1262-63. See 7C C. Wright, A. Miller & M. Kane, Federal Practice and Procedure § 1958 at 559-60 (2d ed. 1986). Here, Rockor controlled Explo's successful challenge to the substitution motion.

The second reason is that the minimum contacts necessary for in personam jurisdiction were intertwined with Rockor's

role in the litigation. "In judging minimum contacts, a court properly focuses on 'the relationship among the defendant, the forum, and the litigation.' Shaffer v. Heitner, 433 U.S. 186, 204 (1977)." Keeton v. Hustler Magazine, Inc., 465 U.S. 770, 775 (1984). When substitution was first sought, Rockor had succeeded to Explo-Excoa's interest in the suit, was financing the litigation and had agreed to indemnify the bonding company in the event of a judgment against Explo. Because it availed itself of Puerto Rico as the forum in the hope of obtaining a judgment that would inure to its benefit and was obviously aware of the nature and progress of the case, Rockor had sufficient contacts with Puerto Rico to meet the fourteenth amendment due process

requirements. Keeton v. Hustler Magazine, Inc., 465 U.S. at 775-76.

There can be little doubt that, at least from the time it acquired Explo-Excoa's interest in the lawsuit, Rockor was the real party in interest. Federal Rule of Civil Procedure 17(a) requires that "[e]very action shall be prosecuted in the name of the real party in interest." Rule 25(c) is, in effect, the continuation of Rule 17.

> Subdivision (c) of Rule 25 deals with transfers of interest during the course of the action. The situation with which it is concerned may be compared and contrasted to that obtaining where a transfer of interest such as by an assignment takes place prior to the commencement of the action. In the latter situation Rule 17 controls and requires that the action shall be prosecuted in the name of the real party. But where the transfer of interest takes place during the course of the action, Rule 25(c) controls and provides that the action may be continued by or against the original party

> whose interest has been transferred, unless the court, upon motion, directs that the person to whom the interest has been transferred be substituted in the action, or joined with the original party.

3B J. Moore, & J. Kennedy, Moore's Federal Practice § 25.08 at 25-77, 78 (1987) (footnotes omitted). Substitution may be ordered after judgment has been rendered in the district court for the purpose of subsequent proceedings to enforce judgment. Id. § 25.03 at 25-27.

In addition to Rockor's ownership of Explo-Excoa and its financing and control of the litigation, there is another reason why Rockor is liable for the amount of the judgment against Explo. The contract between Explo and Garlam contained the following clause: "It is mutually agreed that this Agreement shall bind the heirs, executors, administrators, successors, holding companies and assigns of

the parties hereto." It cannot be doubted that Rockor was a successor to Explo. It also is evident that Rockor, which owned all of the outstanding stock of Explo at the commencement of the action, was a holding company of Explo at the time the contract was executed.

For the following reasons, we hold that Rockor is liable for the full amount of the judgment against Explo and must be substituted for Explo as the defendant to Garlam's counterclaim: Rockor from the beginning was the controlling stockholder of Explo-Excoa; it succeeded to Explo-Excoa's interest in the lawsuit; after the merger of Explo into Excoa and Excoa's dissolution, Rockor became the real party in interest, indeed the only party in interest; Rockor financed and controlled the litigation; and Rockor is bound under the contract between Explo

and Garlam as Explo's successor and a holding company of Explo.

Under these facts and the applicable legal principles, Rockor could not limit its litigation liability to the amount for which it agreed to indemnify the bonding company. Litigation is a two-way street. Once it is entered it must be travelled the full length; except for settlement or bankruptcy, there is no escape route. If Garlam had been found liable, the full amount of the judgment would have gone directly to Rockor. It, therefore, must pay the full amount of the judgment against Explo.

VI. GARLAM'S APPEAL ON ATTORNEY'S FEES, COSTS, AND PREJUDGMENT INTEREST

In its opinion adopting the master's report on damages, the district court found "that Explo has not conducted the

litigation in an obstinate manner and that imposition of pre-judgment interest, costs and attorney's fees is not justified." This decision was within the discretion of the district court and we find no reason for disturbing it.

SUMMARY

We affirm the judgment of the district court on liability and damages. We reverse the order of the district court as to the date from which interest shall be computed. We reverse the order of the district court on the motion for substitution and order that Rockor be substituted for Explo as defendant to the counterclaim. We affirm the order of the district court denying Garlam attorney's fees, costs, and prejudgment interest.

Affirmed in part, reversed in part, remanded.

Costs awarded to Garlam on these appeals.

72397

UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

No. 86-1303

EXPLOSIVES CORPORATION OF AMERICA,
et al.,
Plaintiffs, Appellants,

v.

GARLAM ENTERPRISES CORPORATION,
et al.,
Defendants, Appellees.

No. 86-1362

EXPLOSIVES CORPORATION OF AMERICA,
Plaintiffs, Appellees,

v.

GARLAM ENTERPRISES CORPROATION,
Defendant, Appellant.

No. 86-1650

EXPLOSIVES CORPORATION OF AMERICA,
et al.,
Plaintiffs, Appellants,

v.

GARLAM ENTERPRISES CORPORATION,
et al.,
Defendants, Appellees.

JUDGMENT

Entered: April 30, 1987

These causes came on to be heard on appeals from the United States District Court for the District of Puerto Rico, and were argued by counsel.

Upon consideration whereof, It is now here ordered, adjudged and decreed as follows: The judgment of the district court on liability and damages is affirmed. The order of the district court as to the date from which interest shall be computed is reversed and the cause is remanded to the district court for redetermination of the interest in accordance with this opinion filed this day. The order of the district court on the motion for substitution is reversed and the cause is remanded to the district court with instruction that Rockor be

substituted for Explo as defendant to the counterclaim. The order of the district court denying Garlam attorney's fees, costs and prejudgment interest is affirmed.

Costs awarded to Garlam on these appeals.

By the Court:

Francis P. Scigliano
Clerk

[cc: Messrs. Oles and Cordero]

72395

UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

No. 86-1303

EXPLOSIVES CORPORATION OF AMERICA,
et al.,
Plaintiffs, Appellants,

v.

GARLAM ENTERPRISES CORPORATION,
et al.,
Defendants, Appellees.

No. 86-1362

EXPLOSIVES CORPORATION OF AMERICA,
Plaintiffs, Appellees,

v.

GARLAM ENTERPRISES CORPROATION,
Defendant, Appellant.

No. 86-1650

EXPLOSIVES CORPORATION OF AMERICA,
et al.,
Plaintiffs, Appellants,

v.

GARLAM ENTERPRISES CORPORATION,
et al.,
Defendants, Appellees.

Before

CAMPBELL, Chief Judge,
Coffin, Bownes, Breyer,
Torruella, and Selya,
Circuit Judges

ORDER OF COURT

Entered: June 3, 1987

The panel of judges that rendered the decision in these cases having voted to deny the petition for rehearing and the suggestion for the holding of a rehearing en banc having been carefully considered by the judges of the Court in regular active service and a majority of said judges not having voted to order that the appeal be heard or reheard by the Court en banc,

It is ordered that the petition for rehearing and the suggestion for rehearing en banc be denied.

By the Court,

Francis P. Scigliano
Clerk

[cc: Messrs. Oles and Cordero]

72396

GENERAL CONDITION 4.3
IN GARLAM'S PRIME CONTRACT

4.3 INCREASED OR DECREASED QUANTITIES OF WORK . . .

. . .

c) It is mutually agreed that, if demand is made by either party, overruns or underruns of more than 25% of the total cost, individually, of one or more major items, calculated from the original proposal quantities and the original contract unit prices, shall require a negotiated change of unit price which shall be covered by a supplemental agreement by the Director and the Contractor, setting forth the necessity for the change and the adjustment of unit prices agreed upon a [sic] satisfactory to both parties.

d) It is mutually agreed, that, if demand is made by either party, overruns

or underruns in any or all items resulting in a sum total change of more than 25% of the total cost of the contract, calculated from the original proposal quantities and the original contract unit price, shall required [sic] a supplemental agreement signed by the Director and the Contractor setting forth the necessity for the change and the adjustment of unit prices agreed upon as satisfactory to both parties.

e) The contract does not obligate the Contractor to perform at original contract unit prices, overruns or underruns generating a total in dollars or in extent of more than 25% of the original contract.

GARLAM ENTERPRISES CORPORATION

GENERAL CONTRACTORS

SUBCONTRACT AGREEMENT

WITH

EXPLO CONTRACTORS
EXCOA Building
Issaquah, Washington 98027

DATED: April 28, 1971

72747

SUBCONTRACT AGREEMENT

This AGREEMENT made this 28th day of April, 1971 by and between GARLAM ENTERPRISES CORPORATION, hereinafter referred to as the "Contractor", and EXPLO CONTRACTORS, a division of Explosives Corporation of America which in turn is a subsidiary of Rocket Research Corporation, hereinafter referred to as the "Subcontractor", who is to operate in Puerto Rico under licensed authority of the Commonwealth Government and duly authorized to do work in the Commonwealth of Puerto Rico.

WITNESSETH

WHEREAS, the Contractor has heretofore entered into a contract, hereinafter referred to as the "General Contract, dated January 22, 1971 with the Puerto

Rico Highways Authority, hereinafter referred to as the "Owner", for the construction of Project AC 52 (R)12(70) of the San Juan-Ponce Highway known as "La Palma-Cerro de los Cielos" Section in the Municipality of Salinas, Puerto Rico, which general contract includes the following work to be done under this Agreement: All labor, materials, fuels, lubricants, equipment and services required to complete the work described in Article XVI (c) of this Agreement, in accordance with all applicable plans and specifications prepared by the Architects of the Owner.

NOW THEREFORE, in consideration of the covenants and agreements hereinafter contained and the payments to be made as hereinafter provided, the Contractor and

the Subcontractor do hereby mutually agree as follows:

ARTICLE I - PERFORMANCE AND SCOPE OF THE WORK

That the Subcontractor shall furnish all materials, supplies, equipment and required services and furnish all labor required, except as otherwise herein provided, for the completion of the said work in accordance with all applicable provisions of the General Contract, the specifications, addenda, general and special conditions and the accompanying drawings, all of which documents are hereinafter called the "Contract Documents" and are hereby made a part of this Agreement; and under the direction and to the satisfaction of the Owner's engineer or other authorized representative in charge of said work. The Subcontractor

acknowledges that he has examined and understands and accepts the requirements of the contract documents applicable to this Agreement.

. . .

ARTICLE VII - CHANGE ORDERS IN GENERAL CONTRACT

That the Subcontractor shall be bound by any changes or alterations ordered by the Owner in the work under this Agreement in the General Contract, specifications, general and ~~specific~~ special provisions, and/or plans, or in the amount or character of said work or any part thereof, to the same extent that the Contractor is bound thereby, the payments to the Subcontractor to be adjusted accordingly.

. . .

ARTICLE XVII - SPECIAL PROVISIONS

IT IS MUTUALLY AGREED:

. . .

d. That the Contractor shall be bound to the Subcontractor in all applicable respects, by all the obligations that the Owner assumes toward the Contractor under Contract Documents and by all provisions affording remedies and redress to the Contractor from the Owner, but only to the extent to which Subcontractor, by this agreement, may be a participant therein.

CERTIFIED TRANSLATION

IN THE SUPERIOR COURT OF PUERTO RICO
SAN JUAN SECTION

GARLAM ENTERPRISES CORPORATION,	)	
Plaintiff,	)	CIVIL NO. 76-1431
vs.	)	RE:
PUERTO RICO HIGHWAY AUTHORITY,	)	CIVIL ACTION
Defendant.	)	

COMPLAINT

TO THE HONORABLE COURT:

Comes now plaintiff through undersigned counsel and respectfully alleges and prays:

. . .

"FIRST CAUSE OF ACTION"

8. Paragraph 4.3 of the general conditions of the contract provides that if the project results in a change greater than 25 per cent of the total

cost of the contract calculated on the basis of the original conditions contained in the bid and of the unit prices of the original contract which the Authority claimed from the contractor, the Authority would be obliged to renegotiate the total price of the contract. Pursuant to this clause, Garlam requested the Authority on different occasions to renegotiate the price of the contract and the Authority has refused.

9. The original contract between the parties provided for a total cost of $13,489,412.39. Within this price bid by Garlam, there was included a profit of 15% for a total of $1,759,488.58, thus the total cost for the work without including the contractor's profit was $11,729,923.81. Due to the extra work orders and the change orders and to the increase in the number of items, the

total cost of the work was $23,002,285.60 and the Authority, to this date, has paid the contractor the sum of $19,499,579.76.

10. Since the increment in the operation was greater than 25% Garlam required from the Authority that the contract be renegotiated and the Authority has unlawfully and arbitrarily refused.

. . .

San Juan, Puerto Rico, this 12th day of March, 1975.

CELESTINO MORALES, JR.

72444

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF PUERTO RICO

EXPLOSIVES CORPORATION OF AMERICA,	)	
Plaintiff and third party defendant	)	CIVIL 1-72
vs.	)	
GARLAM ENTERPRISES CORPORATION and FEDERAL INSURANCE COMPANY	)	
Defendants and third party plaintiffs	)	
vs.	)	
GENERAL INSURANCE COMPANY OF NORTH AMERICA	)	
Third party defendants	)	

BOOTLE, Senior District Judge:[1]

This case involves the interpretation of a subcontract under which the plain-

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[1]Senior District Judge of the Middle District of Georgia sitting by designation.

tiff Explosives Corporation of America (Explo) agreed with the defendant Garlam Enterprises Corporation (Garlam) to execute certain rock work required by a prime contract between Garlam and the Puerto Rico Highway Authority (Highway Authority). Trial on the merits was with the consent of the parties divided into two separate trials, this first trial having for its purpose the determination of the issue of liability, a further trial, if appropriate, to be held on the issue of damages (see order of Judge Pesquera of May 30, 1974.) The first trial was held in San Juan January 26-30, 1976, by the court without a jury. After a protracted delay in securing a transcript of the evidence and the allowance of ample time for briefing the case as to the issue of liability is now ripe for decision. The court is indebted to coun-

sel for both sides for thorough and exhaustive written arguments and briefs and for compliance with the court's request for proposed findings of fact and conclusions of law and the court now enters its findings and conclusions.

FINDINGS OF FACT

1. Some time during the month of December 1970, the Highway Authority requested bids for the construction of one portion of a highway leading from the city of San Juan, Puerto Rico, to the city of Ponce in the southern part of the island, which portion was designated as Project Number AC-52(R)12(70) Las Palmas Cerro de los Cielos (Project). Garlam was the lowest bidder with an estimated total cost of $13,489,412.39. The contract required work on a unit price basis on 38 items based on estimates made by

the Highway Authority and the designers Tippetts-Abbett-McCarthy-Stratton (TAMS). The other three items were small items on a lump sum basis.

2. Among the items of work required by the contract, Item 4, under the title of Unclassified Excavations, was the most important item and Garlam made a bid of $2.03 per cubic meter for an estimated quantity of 4.680.000 cubic meters for a total bid price on that single item of $9,070,040.00. This item required among other things, the blasting of rock wherever found.

3. In addition, Item 35 of the Bid Proposal required of Garlam the presplitting of the rock face for which Garlam agreed to a bid price of $1.40 per lineal foot on an approximate quantity of

300,000 lineal feet for a total bid price in that single item of $420,000.00.

4. Some time during the month of April 1971, Explo and Garlam conducted negotiations which matured into a contract executed on April 28, 1971, which was executed again on May 5, 1971, by virtue of which Explo agreed to perform all the mass-blasting necessary under Item 4 of the Bid Schedule at a unit price of 51 cents per cubic meter and agreed further to perform the pre-splitting required under Item 35 of the Bid Schedule at the rate of 70 cents per lineal foot.

5. Immediately after the execution of the contract, Garlam instructed Explo to commence work and to continue with the pre-splitting and blasting in certain stations which Garlam had already worked on since March 1971. Explo for one rea-

son or another was not able to start until the beginning of June 1971.

6. Immediately after the first few shots, Garlam took the position that the material produced by the blasting was not in accordance with the requirements of the subcontract and objected to the size of the material that was produced by Explo.

7. At the beginning of September 1971, Explo had produced very little material and the parent company contracted the services of the law firm of DeGarmo, Leedy, Oles and Morrison, and they in turn retained Mr. Aner W. Erickson, who came to Puerto Rico on the 5th of September for the purposes of examining the slow production of Explo, the controversy with respect to the size of the rock that had to be produced by Explo and an alleged lack of payment on

the part of Garlam to Explo for certain work performed. Mr. Erickson made a report which was not presented in evidence but in his testimony summarized some of his findings and recommendations, and he advised Explo to change some of the administrative and operational personnel and to increase the amount of equipment in use.

8. These recommendations of Mr. Erickson were substantially carried out and the amount of production increased although the material produced was not within what Garlam felt the subcontract required.

9. On November 3, 1971, Explo advised Garlam that it was going to abandon the project and in fact did so and on November 9, 1971, Explo confirmed in writing its abandonment of the project.

10. The filing of this action by Explo followed in which Explo named as defendants Garlam and its bonding company, Federal Insurance Company. Then Garlam counterclaimed, claiming the breach of the agreement and named as a third party defendant Explo's bonding company General Insurance Company of America. In its counterclaim, Garlam alleges that as a result of Explo's breach of the agreement, Garlam was obligated to spend substantial amounts of money to complete the work required by the subcontract, claiming also liquidated damages for delay allegedly caused by Explo, plus amounts necessarily expended in correcting work done by Explo, and in making secondary blastings in order to achieve proper contour as required by plans and specifications, and expenses incurred because of Explo's failure to

split and break rocks and boulders into units of 15" or less.

11. The controversy between the parties started in connection with the interpretation of a unit price clause included in the agreement which reads as follows:

> "Blasted rock fragments shall average up to a maximum of fifteen inches in size."

Garlam's position was that the rock fragments could not exceed 15" generally although it conceded that an occasional large boulder would result from any explosion but argued that under the provisions of the contract Explo had to make a secondary blast of such large boulders in order to reduce them to the maximum size permitted by the agreement. Explo on the other hand suggested in letter dated September 22, 1971, that what the clause meant was "an average maximum." It

was not until September 22, 1971, that for the first time Explo suggested this interpretation of this agreement. Prior to this time it had passively admitted the interpretation of Garlam. For instance, in a letter dated July 27, 1971, from Explo's Mr. Albert E. Teller, director of land operations to Garlam Enterprises, Attention: Ing Marco Delgado, the statement is made "during the same time period as above you agreed to advance the progress of the job by not holding us to the 15 inch section of the contract. This agreement was made so that you could load the muck piles with scrapers." The quoted language recognizes the existence and validity of the 15 inch requirement and states at least one of the reasons for its existence. The quoted language's suggestion that that requirement had been waived, even

temporarily, is not supported by the evidence.

12. During the six month period that Explo was working the project, it did not comply with the interpretation of Garlam as to the maximum rock size although Garlam continuously insisted that Explo produce material not exceeding 15 inches in size.

13. The language quoted above was a composite drafting made by Mr. John W. Goode, a division general manager of Explo, and Mr. Hugh E. Oswald, general counsel for Explo, together with Mr. Raymond W. Garffer, president of Garlam. We find that the words "up to a maximum" were inserted at the insistence of Mr. Garffer and the word "average" originated with and was suggested by Mr. Goode, and Mr. Oswald took together

the set of words and drafted the language which appears in the subcontract.

14. Explo has alleged in the complaint a number of minor violations of the prime contract allegedly committed by Garlam but we find that no evidence has been presented to substantially prove these violations. We further conclude that if these alleged violations had occurred they would not have justified Explo in abandoning the project.

15. The subcontract was negotiated by the parties and it was not a form contract. Time was made of the essence of the agreement because the prime contract did require from the contractor performance of all the work within a specified number of days. An amendment to the subcontract executed May 5, 1971, stipulated that Explo would begin work "on May 12, 1971 for a total of four hundred eighty-

nine (489) calendar days, and shall terminate said work September 22, 1972."

16. The subcontract between the parties provided for partial payments to Explo in accordance with their production at the agreed unit price within ten days after Garlam had been paid by the Highway Authority for that particular work. This payment provision related both to blasting and pre-splitting.

17. The Highway Authority made payments to Garlam in the manner shown in Exhibit G and such exhibit shows that Garlam at no time prior to November 3, 1971 when Explo abandoned the project was actually indebted to Explo except during the month of August 1971, at which time Explo was already indebted to Garlam in a larger amount for certain rental payments and other services which Garlam had rendered to Explo for which Explo had not

paid. It must be noted that this computation, Defendant's Exhibit G, is made on the basis of a deduction of 50% from amounts otherwise due for blasting on account of the oversize of the blasted fragments. While the evidence shows that there was some discussion between the parties with respect to such 50% discount, the evidence fails to show that there was any firmed up agreement or novation with respect thereto. We find as a fact, however, that under the circumstances due to the oversize of the rock fragments, the suggestion of an allowance of only 50% by Garlam was not an unreasonable one, and constituted a good faith gesture on its part. This finding shall in no sense be controlling or binding during the second trial of this case in which the issue of damages will be primarily and directly involved.

We find further that if at any time prior to Explo's abandonment of the project Garlam was indebted to Explo in any amount, it was in such smaller amount in comparison to the totality of the agreement contemplating payments to Explo of at least $1,230,000 that such non- payment was inconsequential. This is particularly true in view of total credit advances (Garlam to Explo of $10,998.91), in view of outstanding bills due by Explo to other suppliers, and in view of Explo's failure to comply with the size requirements of the subcontract.

18. We find that the initial personnel of Explo on this project were not very proficient in blasting techniques and that many erratic decisions were made by them until at least the beginning of October 1971 when proficient personnel

were brought to Puerto Rico to perform the work required by the subcontract.

19. Explo contended that Garlam had no available progress schedule or written schedule of work, and that therefore it was unable to program its activities and that this accounted for its slowness. We find as a matter of fact that Garlam had provided the Highway Authority with the necessary C.P.M. (critical path method) schedules and under the specification and the prime contract, the work had to be programmed from week to week and from day to day. We find and conclude further that under the subcontract, Garlam was entitled to direct the work of Explo from day to day and coordinate Explo's work with its own and with that of other sub-contractors. See Article II a and b of subcontract.

20. Some questions have been raised by Explo as to the sufficiency and propriety of the equipment of Garlam but the evidence fails to show the truth of the allegations or the relevancy of the allegations concerning the issues before the court in this first trial.

CONCLUSIONS OF LAW

A. The subcontract between the parties was negotiated, executed, performed partly and intended to be performed totally in Puerto Rico. It was executed by a Puerto Rico company and a company organized under the laws of the State of Washington authorized to do business in Puerto Rico and payment under the agreement was to be made in Puerto Rico. We conclude therefore that as a matter of law, the interpretation of this agreement

must be made under the provisions of the laws of Puerto Rico.

B. We conclude as a matter of law, that Explo was not a third party beneficiary to the prime contract between the Highway Authority and Garlam, and if any violation of the prime contract occurred, it was a matter to be argued and decided by and between the prime contractor and the Highway Authority. The court therefore holds that any of the alleged violations of the prime contract by Garlam would not justify Explo's failure to perform the subcontract or its abandonment of the project.

C. The subcontract between the parties does not have a termination or rescission clause that will permit Explo to rescind or cancel the subcontract with Garlam. There is no language in the agreement permitting termination, cancel-

lation or recision other than the language permitting Garlam to terminate in the event of certain violations on the part of Explo. If Explo is entitled to terminate the agreement for any reason whatsoever the authorization to do is to be found not in the subcontract but in some other source.

D. Garlam contends that under the laws of Puerto Rico Explo would have no right to rescind the subcontract or to abandon the project, even assuming Garlam's non-payment or withholding of substantial sums earned by and due to Explo and that under such circumstances, Explo's sole redress would be to perform according to Garlam's interpretation of the contract and then demand extra compensation plus interest, citing Article 1051 of the Civil Code of Puerto Rico (31 L.P.R.A. 3025). Explo, on the other

hand, stoutly disputes that the law of Puerto Rico is so different from the law applicable generally in the United States and insists that Puerto Rican law recognizes that substantial non payment excuses performance, citing Article 1077 of the Civil Code of Puerto Rico (31 L.P.R.A. 3052) and the cases Federal Land Bank v. Echeandia, 48 P.R.R. 311; Municipality of Ponce v. Vidal Vilaret, 65 P.R.R. 356 (1945); Fabregas v. Mayaguez L.P. & Ice Co., 43 P.R.R. 197 (1932); Diaz Torres v. Rivera, 96 P.R.R. 548, 555-556 (1968); Perez v. Sampedro, 86 P.R.R. 498 (1962); Portela v. Porto Rican American Tobacco Co., 4 P.R.R. 55 (1903); and Felix A. Rodriquez, Inc. v. Bristol Myers Co., 281 F. Supp. 643 (D. Puerto Rico, 1968).

We need not choose between these sharply conflicting views under Puerto

Rican law because in the case at bar the evidence fails to establish any substantial non-payment.

E. Explo no doubt has rendered some work under the subcontract and Garlam so acknowledges. This first trial does not require from the court any determination as to what amount of payment must be made to Explo, if any. Under the consent order for these bifurcated trials, the determination as to the amount if any, payable to Explo or to be deducted from whatever judgment may be finally rendered in connection with the total amount of damages payable to Garlam, should be made by the trial court during the second trial which will relate to the issue of damages. It is recognized that Explo will be entitled in the second trial to

prove, if it can, substantial performance on its part in which event

> "The true measure of recovery is the sum stipulated in the contract less the damages sustained by its failure strictly to perform."
>
> 13 Am. Jur. 2d Building and Construction Contracts § 80, p. 82 (1964), and 66 Am. Jur. 2d Restitution and Implied Contracts § 72, p. 1016 (1973).

Doubtless this same principle of law should be applied in determining the amount of credit, if any, to which Explo is entitled against any larger damage award which may be made in favor of Garlam. No findings are made as to the amount of damages, if any, that may be chargeable to Explo due to the lateness in the completion of the work. Such matter should be decided by the trial court in the second portion of this case. We conclude as a matter of law, however, that the measure of the amount of monies

for which Explo is entitled to be credited in exchange for the work done by it should be on the basis of the agreement of the parties as evidenced by the subcontract, that is to say at the rate of 51 cents per cubic meter of blasted rock and 70 cents per line foot of pre- splitting. We conclude as a matter of law that the measure of payment should not be on the basis of value or quantum meruit. See 66 Am.Jur.2d Restitution and Implied Contracts § 73, p. 1017, and United States v. Western Casualty and Surety Co., 498 F.2d 335 (9th Cir. 1974).

F. The language contained in the unit price clause is ambiguous and therefore it is necessary to apply the rules of interpretation contained in the Civil Code of Puerto Rico. Title 31 § 3478 of that code reads as follows:

> "The interpretation of obscure stipulations of a contract must not favor the party occasioning the obscurity."

The language of the unit price clause was finally drafted by Mr. Hugo E. Oswald. Jr., then general counsel for Explo, in the negotiations of the subcontract. While both Garlam and Explo contributed some of the complicating words, the final drafting was actually done by Mr. Oswald. We conclude as a matter of law that the obscurity of the language must be charged to Explo and that the correct interpretation of the unit price clause is that the material to be produced must be generally within the range of 15 inches or less. We conclude that otherwise Garlam could not comply with other requirements of the prime contract which required it to dispose of the rock fragments to construct compaction layers of approximately 6

inches in the embankments and 24 inches in the rock fills. The interpretation of the clause suggested by Explo creates an absurd situation which this court rejects. Its suggested interpretation is inconsistent with its explicit contractual obligation to blast "secondary boulders that may appear after a blasting operation, if required by the contractor." Therefore, in the determination of the amount of work done by Explo, consideration should be given to the contractual requirement that Explo produce material which finally could not exceed 15 inches as a maximum size and that such other larger boulders had to be broken down by secondary blasting if they exceeded this maximum of 15 inches.

G. As a consequence of this breach by Explo, Explo is obligated to pay to Garlam the actual and necessary addi-

tional costs reasonably incurred by Garlam in order to complete the work required of Explo by the subcontract. As above indicated, the question whether or not any delay penalty is chargeable against Explo and if so, how much, is to be determined by evidence adduced in the second trial. The question of interest on any amounts credited to or chargeable against Explo is likewise to be determined by evidence adduced at the second trial. All costs of this first trial are taxed against Explo.

H. Garlam's counterclaim prays for judgment against Explo and General Insurance Company of America in the amount of $4,120,000. As an affirmative defense, General Insurance Company of America asserts that any liability it may have in relation to the project which is the subject of this litigation arises out

of a payment and performance bond in the amount of $1,230,000 and that said sum is the maximum amount of any liability it may have. Garlam contends, on the other hand, that General Insurance Company of America's liability is not limited to the penal sum named in the bond on that Explo is entitled to judgment against said bonding company for any amount it may be entitled to recover against Explo, even though said amount may be in excess of $1,230,000. Judicial restraint dictates that this particular question be deferred for the second trial. It need not be decided then unless Garlam enjoys a recovery against Explo in a net amount exceeding $1,230,000.

DISCUSSION

ADDITIONAL FINDINGS OF FACT AND CONCLUSIONS OF LAW LESS FORMALLY STATED

When Explo Entitled to Receive Payments

Under Article XIV "Basis and Scope of Payment," the subcontract provides:

> Payment shall be made to the subcontractor for work hereunder actually performed and completed as measured and certified by the owner's engineer, in strict accordance with payments made to the contractor for this work and materials and within ten (10) days after receipt by contractor of payment from the owner for such work and materials, at the unit prices hereinafter specified.

Under Article XV "Partial Payments," the subcontract continues:

> Partial payments for the work performed under this agreement shall be made by the contractor as and when payments therefore [sic] are made to the contractor by the owner, and will equal the value of the work done by the subcontractor according to the engineer's estimate at the unit prices hereinafter specified, or

> at a proportionate part of the lump sum price for the subcontractor's work, less the sum of previous payments and less a percentage equal to the percentage retained by the owner provided that if the subcontractor is indebted to the contractor or anyone else for cash advances, supplies, material, equipment rental, or other proper charges against the work, the amount of such indebtedness may be deducted from any payment or payments made under this provision; . . . For clarification, basis of payment of the owner is monthly certifications approved by the inspectors and engineers representing the owner on the project, less ten (10) percent withheld until final liquidation of project. In turn, the contractor will pay the subcontractor for the amount of work certified and in turn will retain ten (10) percent of the amount certified, paying the balance to the subcontractor within ten (10) days after receipt of payment by the owner of certification to the contractor.

Thus, according to the terms of the subcontract, Explo was entitled to receive partial payments only "according

to the [owner's] engineer's estimate at the unit prices hereinafter specified, or at a proportionate part of the lump sum price for the subcontractor's work" and was entitled to receive such partial payments only "as and when payments therefore [sic] are made to the contractor by the owner" and "if the subcontractor is indebted to the contractor or anyone else for cash advances, supplies, material, equipment rental, or other proper charges against the work, the amount of such indebtedness may be deducted from any payment or payments made under this provision." Insisting upon the terms of this contract, Garlam contends that prior to Explo's abandonment of the project, Garlam was indebted to Explo only during August 1971 and that when that payment was due, Explo was already indebted to Garlam in a larger

amount for rental payments and other services and was also indebted to other suppliers for proper charges against the work. These specific contentions of Garlam are shown in figures from an account's point of view in Defendant's Exhibit G, page 1 of which is captioned "Explo Contractors--Breakdown of Work Performed Before Default on 11-3-71." Explo's contrary contentions are summarized in Plaintiff's Exhibit 15 which was prepared by Explo's witness, Mr. Aner Erickson in which he shows considerable discrepancies between Explo's invoice claims and his adjusted claims, his figures being generally much smaller than the figures reflected on the invoices. For instance, whereas Explo's invoice for services through June 30, 1971 claimed 22,630 cubic meters blasted, Mr. Erickson's adjusted claim is 16,500;

the invoice for services through August 17, 1971 claimed 107,034 cubic meters whereas Mr. Erickson's adjusted figure was 64,200; the invoiced claim for services through September 30, 1971, was 159,880 cubic meters whereas Mr. Erickson's adjusted figure is 117,110; and the invoice figure for services through October 30, 1971 was 169,000 cubic meters whereas Mr. Erickson's adjusted figure is 136,800 cubic meters. All figures on Plaintiff's Exhibit 15 are cumulative and whereas for the entire period Explo had prepared invoices for 169,000 cubic meters blasted and for 20,000 lineal feet of pre-splitting, Mr. Erickson says the cumulative figure should have been 136,800 cubic feet of blasting and 11,733 lineal feet of pre-splitting. The net result of Plaintiff's Exhibit 15 is an assertion by

Explo that prior to its withdrawal from the job, it had earned a total of $59,184.08 after giving credit for amounts paid or advanced to Explo by Garlam by way of rental equipment, etc., totalling $10,998.91, about which latter figure there is no dispute. Plaintiff's Exhibit 15, however, does not take into consideration or answer Garlam's contention that no amounts were due Explo until "after receipt by contractor of payment from the owner" nor does it take into account debts owed by Explo to other suppliers. And of course Plaintiff's Exhibit 15 assumes that its blasted rock fragments satisfied the size requirements of the subcontract so as to entitle it to payment, and full payment, for all its blasting operations.

We find as a fact that even if at any time prior to Explo's abandonment of the

project it was entitled to receive any payment from Garlam beyond the $10,998.91 in advanced credits the amount of any such additional entitlement was insubstantial and the non-payment of the same would not constitute cause for Explo's abandonment of the project or cause for Explo's attempt to rescind the subcontract. See U.S. v. Southern Constr. Co., 293 F.2d 493, 498 (6th Cir. 1961) and Guerini Stone Co. v. P. J. Carlin Construction Co., 248 U.S. 334, 63 L.Ed. 275 (1919) [sic].

Interpretation of

"Blasted Rock Fragments Shall Average up to a Maximum of 15 Inches in Size"

While the unit bid prices for the subcontract were negotiated between Explo and Garlam prior to the execution of the formal subcontract agreement, it was

mutually understood that such price negotiations were tentative only and that there would be no binding agreement until a formal contract was agreed upon and signed. For instance, Explo's letter to Garlam dated April 2, 1971, signed for Explo by John W. Goode, general manager, and quoting the unit prices, concluded with this paragraph:

> "This letter is not intended to become a binding agreement between us. Any such agreement will be evidenced by a formal contract mutually agreeable to both parties."

Although the prime contract permitted Garlam to use, under certain conditions, rock larger than 15 inches in its greatest dimension (even up to approximately 4 feet in a limited and prescribed manner) it did not require the use of such sizes and nothing prevented Garlam from

requiring of its subcontractor smaller sizes.

Explo solicited of Garlam the subcontract, representing itself as possessing expertise in the field of blasting and knowledge as to improved techniques. During the negotiations leading up to the subcontract Explo's representative, Mr. Teller, represented to Mr. Garffer, Garlam's president, that Explo could give Garlam "a 4 to 6 inch product." Transcript p. 343. Garlam relied upon these representations and was willing to settle for a product with a maximum dimension at its greatest length of 15 inches. (He realized, of course, there would not be 100% minus 15-inch product but was sticking to a requirement of "minus 15, because 90 to 95% of the material had to be minus 15 inches, which would be an average of 8 inches.")

Transcript p. 324. Thus, Garlam would not have objected to something like 5% erratics but throughout the negotiations, its president Mr. Garffer was adamant in his insistence upon a maximum of 15 inches. He never wavered in that insistence.

Significant is the fact that Explo's negotiator, general counsel Mr. Goode, well knew of Mr. Garffer's insistence. Mr. Goode claims that during the negotiations he had some discussion with Mr. Delgado, an employee of Garlem, out of the presence of Mr. Garffer and the other negotiators, concerning "how we might be able to work around that clause (the 15 inch maximum) in the field, and how to accomplish the job," and while he does not claim any modification of the subcontract, he claims that he "thought" he reached some understanding on the side

with Mr. Delgado. Goode deposition, p. 22,23,24. Mr. Goode's testimony in this regard is in sharp conflict with the testimony of Mr. Delgado from whom Explo's counsel was never able to obtain any admission with respect to any side conference or agreements between Mr. Delgado and Mr. Goode. Transcript p. 458,459. Significant also is Mr. Goode's testimony with respect to his claimed side conferences with Mr. Delgado that "We didn't want to carry the argument to Mr. Garffer any more than necessary. We wanted to get through with the negotiations and eventually with the word average, that was what I decided to accept finally in the final contract." Mr. Good obviously knew that Mr. Delgado was without authority to act in the premises contrary to the wishes and determination of Mr. Garffer who was com-

pletely in charge for Garlam in the negotiation of the subcontract. Mr. Goode knew further of Mr. Garffer's insistence upon the limitation of 15 inches as a maximum. This brings into play a principle of law codified in Georgia at Title 20 § 703 under the subject of Contracts as follows:

> "Intention of one party known to the other.--The intention of the parties may differ among themselves. In such case, the meaning placed on the contract by one party, and known to be thus understood by the other party, at the time, shall be held as the true meaning."

See also the case of Peninsular Naval Stores Co. v. Parrish, 13 Ga. App. 779 (1913) [sic] applying this principle.

In interpreting the contract language in dispute, there are certain fundamental rules to guide us.

> " 'To ascertain the intent of the parties is the fundamental rule in the construction of

agreements (Chesapeake & O. Canal Co. v. Hill, 15 Wall. 94, 21 L.Ed. 64); and in such construction courts look to the language employed, the subject-matter, and the surrounding circumstances. They are never shut out from the same light which the parties enjoyed when the contract was executed, and in that view they are entitled to place themselves in the same situation which the parties who made the contract occupied, so as to view the circumstances as they viewed them, and so to judge of the meaning of words and of the correct application of the language to the things described.' "

Town of Ashland v. Newman, 163 Va. 500, 175 S.E. 724, 726, 176 S.E. 470.

[3,4] It is a universal canon of construction that every word and phrase in a contract should be given a meaning and signification according to its importance in the context of the contract. Courts are not warranted in reading out of a contract words or phrases placed there by the contracting parties unless they cannot be rationally fitted into the scheme of the agreement between the parties. Vitagraph Inc., v. American Theatre Co., 77 Utah 71, 291 P. 303; La Lumia v. Northern

California Packing Co., Cal. App., 172 P.2d 94; Maryland Casualty Co. v. Morrison, 10 Cir., 151 F2d 772.

Basler v. Warren, 159 F.2d 41, 43 (10th Cir. 1947).

Thus, first of all we are to seek to ascertain the intent of the parties. We are to consider the subject matter of the agreement, the circumstances which surrounded the parties and the language which they used, insofar as possible giving adequate consideration to each and every word. Applying these principles, the language itself leans heavily toward the intepretation advocated by Garlam. The words "up to a maximum of 15 inches" are hard to explain away. They cry out for recognition. Explo would have us erase both "up to" and "maximum of" and read the subcontract as if it said only "shall average . . . 15 inches." While obviously there is some uncertainty and

vagueness to be attributed to the word "average", there is no room for doubt as to the exact meaning of "up to a maximum of 15 inches." The word "average" was selected by Explo and Explo is chargeable with its vagueness. Under the language used, the size might "average" or range from any minimum size Explo desires, but only "up to a maximum of 15 inches."

We find that the evidence does not establish any of the alleged breaches of the contract by Garlam as contended for by Explo and we find that the real reason for the abandonment of the project by Explo was not any breach or failure of performance on the part of Garlam, but was Explo's decision to abandon what for it was proving to be an unprofitable contract.

CONCLUSION

Liability is accordingly hereby fixed upon Explosives Corporation of America and upon General Insurance Company of America in accordance with the findings of fact and conclusions of law above expressed.

This 30th day of March, 1977.

W. A. Bootle
Senior U.S. District
Judge

VERDICT

On the issue of liability the court hereby finds in favor of Garlam Enterprises Corporation and Federal Insurance Company against Explosives Corporation of America and General Insurance Company of America in accor-

dance with findings of fact and conclusions of law of even date.

This 30th day of March, 1977.

W. A. Bootle
Senior U.S. District
Judge

72517

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF PUERTO RICO

EXPLOSIVES CORPORATION OF AMERICA, Plaintiff and Third Party Defendant vs. GARLAM ENTERPRISES CORPORATION and FEDERAL INSURANCE COMPANY Defendants and Third Party Plaintiffs vs. GENERAL INSURANCE COMPANY OF NORTH AMERICA Third Party Defendants	CIVIL NO. 1-72

ORDER

This matter came before the Court for a hearing on several pending motions. After considering briefs and other documents filed by the parties and hearing

oral arguments by counsel, it is hereby ORDERED:

1. Motions for Partial Summary Judgment on the Issue of the Extent of the Surety's Liability.

The motion of Garlam Enterprises Corporation for partial summary judgment is denied. The motion of General Insurance Company of North America is granted.

The Payment and Performance Bond issued by General Insurance Company of North America indicates a penal sum of $1,230,000. The general rule is that the maximum liability of a surety is the penal sum named on the bond. As an exception to the rule, a surety may be liable for a sum in excess of the penal sum when it undertakes to complete the project upon the default of the principal. Barrientos v. Govt. of the Capital,

97 PRR 539, 556-7 (1969): 17 Am. Jur. 2d, Contractor's Bond, § 131.

It does not matter whether the contract under which the surety's principal is bound is a lump sum or a unit price contract; the principle is the same. A surety binds itself (except in particular circumstances not present here) only to pay up to the penal sum in case its principal defaults. The premium paid by the principal is calculated on the basis of the penal sum and the decision of the surety on whether to issue the bond up to that amount usually depends on the financial capability of the principal.

In this case, Garlam Enterprises Corporation and Explosive Corporation of America estimated, on the basis of information given by the owner, the amount of work involved. General Insurance Company of North America took the figure supplied

by it and issued the bond for a specific amount. Its liability is limited to that amount.

. . .

It is so ordered.

San Juan, Puerto Rico, October 20, 1977.

U.S. DISTRICT JUDGE

72739

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF PUERTO RICO

EXPLOSIVES CORPORATION OF AMERICA Plaintiff and Third Party Defendant vs. GARLAM ENTERPRISES CORPORATION and FEDERAL INSURANCE COMPANY Defendants and Third Party Plaintiffs vs. GENERAL INSURANCE COMPANY OF NORTH AMERICA and ROCKOR, INC. Third Party Defendants	CIVIL NO. 1-72

ORDER

On July 22, 1979, this Court issued a Memorandum and Order denying ROCKOR's motion to dismiss the third amended complaint. ROCKOR had contended that

dismissal was mandated insofar as said amended complaint brought ROCKOR as a party hereto, and we lacked jurisdiction against said party insofar as it was not "doing business" in Puerto Rico under International Shoe v. Washington, 326 US [sic] 310 (1945). After recognizing that ROCKOR and Explosives Corporation of America (EXPLO, plaintiff herein), were separate and distinct corporate entities,1/ we held that by acquiring EXPLO's claim as alleged creditor in this case and electing to exercise said claim, ROCKOR had "conducted activities within the forum state" and thus submitted itself to the jurisdiction of this court.

1/ The basic facts as to the pertinent chronology of events and the corporate relationship between the parties contained in our Memorandum and Order of July 22, are adopted herein.

ROCKOR has now filed a motion for reconsideration and/or certification wherein they contend, inter alia, that our ruling should be reconsidered inasmuch as subjecting ROCKOR to the jurisdiction of this Court would go against the basic postu--lates [sic] of International Shoe, supra, and constitute a denial of due process. Defendant and Third Party Plaintiff Garlam Enterprises (Garlam) has opposed said motion on various grounds. For the reasons to follow, we agree with ROCKOR and accordingly dismiss this action as to said Third Party Defendant.

Generally, a determination of whether a federal court may assert jurisdiction over a corporation under state law as expressed in International Shoe, supra, progeny is approached in terms of whether said defendant's local activities consti-

tute "doing business". See 4 Wright & Miller S-1069. Puerto Rico's long-arm statute, Rule 4.7 of the local Rules of Civil Procedure, was intended to expand the thrust of jurisdiction to its full constitutional limit. Ramon Vela, Inc. v. Sagner, 382 F. Supp 478 (D.C.P.R. 1974). It is nevertheless an undisputed fact in the instant case that third party defendant ROCKOR is not "doing business" in the conventional sense within the geographical boundaries of Puerto Rico inasmuch as it has had no office, conducted no sales or lucrative ventures, signed no contracts or otherwise employed its business resources directly or indirectly as a corporate entity in this island. Assertion of local jurisdiction could only befall if the agreement by which Explosives Corporation of America's assets were conveyed to ROCKOR's prede-

cessor Rocket Research Corporation (including EXPLO's claim against Garlam) constituted "doing business" as expressed above. (There is no question that the transfer of assets from EXCOA to ROCKOR occurred outside of Puerto Rico.)

As in Schenin v. Micro Copper Corp., 272 F. Supp. 523 (SDNY 1967), the instant case does not concern a statutory merger between EXCOA and ROCKOR, but an acquisition of the former's assets by the latter. Accordingly, ROCKOR's liability vel non to Garlam would depend on the applicable law and facts but has no bearing on whether jurisdiction may be asserted over ROCKOR in this forum. Garlam must present whatever claim it alleges in the appropriate forum. As stated in Schenin, supra, at 526:

> "Whether or not plaintiff could sue [defendant] directly - for example, on a third party bene-

> ficiary theory - would depend on the applicable law, but he could sue [defendant] only where it could be found".

As in said case, Garland has presented us with no set of facts that would establish a basis to impute to ROCKOR, for jurisdictional purposes, activities of EXPLO or EXCOA in Puerto Rico.

Garlam alleges that initial negotiations subject of this litigation were undertaken by ROCKOR and that ROCKOR approved the contract object of this suit before it was executed inasmuch as ROCKOR was financing this operation and is financing this litigation. These unsuported [sic] allegations fall flat on the face of the facts established by ROCKOR in support of its motion. Garlam has been unable to produce sufficient evidence of ROCKOR's direct involvement in the local controversy so as to "do

business" in Puerto Rico. As noted above, mere acquisition of assets is not enough to submit a foreign corporation to local jurisdictional statutes. Likewise, mere supervisory endeavors of a subsidiary or wholly owned company by a parent is insufficient to assert jurisdiction over the parent company. Cf. W. Clay Jackson Enterprises v. Greyhound Leasing 431 F Supp 1229 (D.C.P.R. 1979) (total control over subsidiary by parent company coupled with identity of members of boards and abundance of "instances evincive of close control of subsidiary by parent" was enough to subject parent to jurisdiction under the local long-arm statute). Furthermore, any subsequent inherence in this litigation by ROCKOR has no bearing on the jurisdictional issue before us. Dragor Shipping Corp. v.

Union Tank Car Co., 361 F2d 43 (9 Cir. 1966)

Wherefore, in view of the fact that we now find that third party defendant ROCKOR was not "doing business" in Puerto Rico as understood under International Shoe, supra, and that said party is otherwise not subject to jurisdiction under Puerto Rico Rules of Civil Procedure 4.7, it is now hereby

ORDERED that ROCKOR's motion for reconsideration be and the same is hereby GRANTED and the instant case is hereby dismissed as to said third party defendant.

Judgment shall be entered accordingly.

SO ORDERED.

San Juan, Puerto Rico, October 29, 1979.

HERNAN PESQUERA
U.S. DISTRICT JUDGE

72737

EXCERPTS OF TESTIMONY
FROM GARLAM ENGINEER, MR. CORDERO

. . .

Q Mr. Cordero, I call your attention to Exhibit 10, please.

A Yes.

Q What does that exhibit represent?

A This exhibit shows an estimate of rock excavation.

Q Who prepared that document, Mr. Cordero?

A This document was prepared in engineer DaSilva's office in order to make an estimate of the amount of additional burrow [sic] material that had to be obtained, this information was supplied by the designers of the project.

Q Do you recall, Mr. Cordero, when was this document prepared, more or less?

A Garlam notified the Highway Authority that it was going to need some burrow [sic] material on November of 1972, and then the first extra work order for burrow [sic] was made in April, no, in June of 1973, which means that this was prepared, I am almost sure that this was prepared at a meeting held in engineer DaSilva's office around March of 1973 between the

designers, the resident engineer and Garlam.

Q And what does this figure of 1,507,000 supposed to mean or refer to?

A This was what the designer and the other persons present therein understood was sound rock.

Q Mr. Cordero, is 1,507,000 units, or 1,507,000 yards, or what is it supposed to be?

A These are cubic meters.

. . .

IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF PUERTO RICO

EXPLOSIVES CORPORATION OF AMERICA	"	
Plaintiff and Third Party Defendant,	"	
vs.	"	
GARLAM ENTERPRISES CORPORATION AND FEDERAL INSURANCE COMPANY,	"	CIVIL NO. 1-72
Defendant and Third Party Plaintiffs,	"	
vs.	"	
GENERAL INSURANCE COMPANY OF NORTH AMERICA AND ROCKOR, INC.	"	
Third Party Defendants	"	

REPORT OF SPECIAL MASTER

TO THE HONORABLE COURT:

The undersigned Special Master by designation, respectfully submits the

following report under Rule 53 of the Rules of Civil Procedure.

By Order of October 20, 1977, the Court determined the appointment of a Special Master. By Stipulation dated October 31, 1978, the parties agreed that the undersigned be appointed Special Master. On September 10, 1979, the Court issued an Order of Reference, hereby marked as Document "A". The Order (Paragraph II) required the Special Master to hold a session within 20 days to docket further hearings to receive testimony and evidence. Said session was held on September 27 by Order submitted on September 18, 1979 (Document "B"). The Special Master designated Mr. Fernando Altamirano as Reporter. A transcript of the proceedings of said session is included as Document "C". On September 27, 1979 the Special Master

designated October 29, 1979 for the purpose of commencing the hearings, Document "D".

Parties as per Order of the Master, filed Memorandum of their respective positions in connection with the matters set forth in the Order of Reference.

Hearings were held on October 28, 30 and 31. The transcript of said proceedings are included as Document "E". By Order of the Master, both parties filed Post-Trial Memorandum, Reply Briefs, Motions and Memorandums, designated as "Documents F from Garlam" and "Documents E from Explo."

At the hearings various Exhibits were received in evidence and are included as part of this Report, that is, Garlam Enterprises Corporation exhibits marked

with numbers and Explosives Corporation of America exhibits marked with letters.

Final Analysis and Informal Notes by Special Master are also included, marked as SM.

In compliance with the September 10, 1979 Order of Reference by Honorable Hernan Pesquera, Judge of the U.S. District Court, on March 19, 1980 the Special Master submitted to the parties the required Draft Preliminary Report, requiring their comments and recommendations.

Replies for both parties were received on time, submitting their recommendations and further commenting on the other party submittal.

Special Master analized [sic] the documentations submitted by both parties

and discussed same in Special Master Final Analysis, presented as exhibits.

Without taking into consideration the Garlam opinion of prejudice and partiality, Special Master deems important to emphasize that all conclusions reported are based on specific facts, discussed thoroughly and openly, considering only the documents-information presented in the proceedings, obviously complementing the study, as any responsible professional will do, with technical publications on the subject matter. The Special Master did not receive any testimony outside the hearings, being personally responsible for all analyses, calculation and drafting of details and report.

As to the indication by Garlam of mathematical errors in the Draft Report, as shown in Special Master Final

Analysis, some are due to errors in typing which did not affect the results, and others are due to errors in Garlam previous Motions.

STATEMENT OF FACTS

This case came before the Special Master by designation, to determine the amounts, if any, which may be due by Explosives Corporation of America to Garlam Enterprises Corporation, under the findings previously made by the Honorable Judge William Bootle on March 30, 1977. In addition to this requirement, the Honorable Court outlined 18 particular items of facts to be specifically examined.

This case came before the Court upon the filing of a complaint by Explosives Corporation of America (Explo) on January 3, 1972 claiming payment for the

value of certain pre-splitting and blasting work done on a portion of the San Juan-Ponce (Las Americas Expressway), Project La Palma Cerro de los Cielos, as a Subcontractor of Garlam Enterprises Corporation (Garlam), Prime Contractor Project No. AC-52-R-(12)-70.

Garlam subcontracted with Explo for the pre-splitting and blasting of rock, at the rate of 70 cents per lineal feet and 51 cents per cubic meter, respectively, under subcontract dated April 28, 1971.

The Prime Contract showed pre-splitting as an item of rock (Item 35), but blasting was included as part of Item 4 entitled "Unclassified Excavations."

Explo performed under the Subcontract from about June 11 to November 3, 1971, when it abandoned the project. Garlam

completed the work required by the Subcontractor.

Upon the filing of the complaint, Garlam answered denying the allegations and claiming instead that Explo breached the contract and counterclaimed against Explo and its Surety.

By Order of the Court, the case was divided into two trials; one to determine liability and a second trial to determine the amount of damages.

Judge W.A. Bootle, Senior Judge, District Court of March, Georgia by designation, heard the first trial and ruled on March 30, 1977, that Explo was liable for damages to Garlam (Exhibit A).

In accordance with the instructions of the Honorable Court, the undersigned deems it necessary, as a preamble, to discuss and analize [sic] the case and

then proceed with the determination as outlined in the Order of Reference.

GENERAL DESCRIPTION OF THE DEVELOPMENT OF CONSTRUCTION PROJECT

On January 22, 1971 Garlam contracted with the Highway Authority the construction of Project AC-52-R(12)-70 for the amount of $13,489,412.39, to be constructed in 600 consecutive calendar days.

According to contract documents the original project covers 41 construction items of which the following are considered the main or principal items related to the case.

ITEM			UNIT PRICE	AMOUNT PAID
4	4,468,000 cu mt	Unclassified Excavations	$2.03	$9,070.040
5	46,880 cu mt	Unclassified Excavations for Structures	$5.73	$ 268,622
35	300,000 ln ft	Presplitting	$1.40	$ 420,000

As presented by Explo during the proceedings, Civil Case 76-1431- Garlam vs. Highway Authority, the development of the project reflected that the scope of the project, specially the construction cost, was markely [sic] increased including excavation, earth work and specially, construction time.

The 41 original construction items were increased to 98 items, 30 work orders and 9 change orders were approved, construction time was increased 1552 calendar days to June 8, 1975 and the project was liquidated by the Highway Authority for $19,499,579.16, that is 31% over original contract cost. Neverthe-

less, Garlam per Motion dated August 10, 1979, is demanding from the Highway Authority over $15.8 millions, in addition to interest and lawyer's fees, in which $4.5 millions are included to cover for compensation for completion of the project ahead of time, that is a bonus of $2,300 per each calendar day, 1959 days over contract time and extensions approved by the Highway Authority.

Material worked by Garlam amounted to 6.04 millions cubic meters and after considering a swell factor of 20% it amounted to a compaction figure of 7.25 millions cubic meters, as compared to the original 4.468 millions cubic meters of Unclassified Excavations figured in the original contract, as a balanced project.

On this token, the following comparable figures should be emphasized:

CONTRACT TIME, calendar days

Original Contract	600
Definite Project Authorized by Highway Authority	2152

CONSTRUCTION COST, dollars

Original Contract	$13,489,412.00
Definite Project	
Authorized by Highway Authority	$19,499,579.00
Demanded by Garlam, in addition to	$15,828,831.00
Total demanded final cost	$35,328,410.00

MATERIAL WORKED, EXCAVATORS - COMPACTION,

Original Contract as a balanced project	4,468,000 cu mts
Definite Project	
Liquidation by Highway Authority	5,054,338 cu mts
Demanded by Garlam	6,042,027 cu mts
Add 20% for swell factor	7,250,432 cu mts

RELATION OF EXPLO SUBCONTRACTORS TO PRIME CONTRACT - SUBCONTRACT

Explo was subcontracted to do all presplitting-drilling and blasting, "including the protection of his work that may be require [sic] to make the various operations subcontracted for to fit it to be received by the Contractor in accordance with other operations of work performed on the Project."

Presplitting was contracted at $0.70 per ln ft compared to $1.40 per ln ft in Prime Contract, and mass blasting for rock excavation at $0.51 per cubic meter, which is part of the $2.03 per cubic meter agreed to in Prime Contract for Unclassified Excavations.

Article XVI of the Subcontract required that the locations indicated to the Subcontractor for mass blasting be surveyed before and after blasting. "All

blasting locations will be indicated to Subcontractor by the Contractor who in turn will take a survey of cross sections in the bank before blasting as well as after cleaning the blasted material and after any excavations of dirt until solid rock is found, where bulldozing and ripping are not effective."

"Payment shall be made to the Subcontractor for work hereunder actually performed and completed as measured and certified by the Owner's Engineer . . ." (Article XIV)." [sic] "Partial Payments for the work performed under this agreement shall be made by the Contractor as and when payments therefore [sic] are made to the Contractor according to the Engineer's estimate, at the unit prices hereinafter specified . ." (Article XV).

Blasting is included in Item 4 of the Prime Contract as Unclassified

Excavations which is the term used to cover ripping and removal of the overburden, after cleaning and grubbing with heavy equipment to the hard rock-blasting the rock, dozing and cleaning the blasted material with heavy equipment and finally transporting same to the fill sites. Complementing the process,stake out surveying is done by the Contractor and Engineer on the hard rock so as direct presplitting and the blasting process.

Explo Subcontractor, blasting and presplitting phase, was completely subordinated to the construction process established by the Prime Contractor of cleaning-grubbing-ripping and removal of overburden-cleaning and grubbing to hard rock-staked out surveying. After presplitting and blasting the Prime Contractor must do the dozing and cleaning of the blasted material and

final surveying of cross sections for partial payments.

RESPONSIBILITY OF SPECIAL MASTER TO REACH A CONCLUSION AS TO THE ORDER OR REFERENCE

During the proceedings of the case, Explo continuously stressed that the burden of proof is upon the party asserting the damages to prove with a reasonable degree of certainty, upon failure to do so, the action be dismissed.

As to Garlam, his position was summarized on Reply Memorandum, November 16, 1979.

> "As a consequence, they (Explo) did what Judge Bootle concluded to be, the breach of the contract, because it was an unprofitable contract."
>
> "But Explo made another mistake. After they breached the con-

tract, they forget about Puerto Rico and permitted the completion of the contract without any kind of supervision on their part. That is the reason that they can present no evidence. And that is the reason why, they cannot inform the Special Master whether the calculation of Garlam are right or wrong."

It was clearly proved that Explo breached the contract as Subcontractor to Garlam and as permitted by Article XII Contractor's Right to Take Over Subcontractor Work, Garlam continued with the Work and complete it with its own forces.

This same Article XII states that neither by the taking over of the work nor by its completion in accordance with the terms of this provision shall the

Contractor forfeit its right to recover damages from the Subcontractor or from Subcontractor's Surety for failure to complete or for the delay in such completion.

> On the consideration of proof of damages, the Courts have sustained that when a contract is breached, the wrongdoer is not exonerated for his misconduct merely because the determination of the amount of damages sustained may be somewhat speculative, nevertheless the damages to be recoverable degree of certainty, the Courts mean that it must be shown with a reasonable degree of certainty that the complaining party has actually suffered damages. It has no reference to the amount

of damages suffered and the fact that the amount of damages must be estimated, does not prevent their recovery.

Determination of damages for breach of a contract is an inexact science and the amount reached by whatever method used will never be more than approximation. This impossibility of precise determination is generally recognized and the Courts do not require mathematical certainty. Recognizing the evidential difficulties inherent in fixing damages to inflexible monetary terms, Courts adjust themselves to the exigencies of the business world.

If a reasonable probability of damage can be clearly established, uncertainty as to the amount, will not preclude recovery. The amount may be approximate if a reasonable basis of computation is afforded.

Difficulty of ascertainment is not to be confused with the right to recovery, nor does it exonerate the defendant from his misconduct. The defendant who has wrongfully broken a contract should not be permitted to reap advantages from his own wrongdoing insisting on proof which by reason of his breach is unobtainable.

> The most elementary conceptions of justice and public policy requires that the wrongdoer shall bear the risk of uncertainty which his wrong act has created.

The undersigned, in order to reach the following determinations and taking into consideration that the necessary technical information that would permit exact engineering conclusions was not made available to him by either party, went into an intensive evaluation of all documents - information and analysis submitted by the parties in the proceedings and conducted an in depth of all material included in both court cases presented in the proceedings Explo vs. Garlam and Garlam vs. Highway Authority, finally performing an extensive research on technical books and publications related to

subject matter.

A. THE QUANTITIES OR ROCK DRILLED AND SHOT (MASS-BLASTING AND PRE-SPLITTING) WITHIN THE ORIGINAL CONTRACT LIMITS ON THE PROJECT WHICH IS THE SUBJECT OF THIS ACTION

As stated in the following documents in Explo vs. Garlam Case and Garlam vs. Highway Authority, Garlam, for the last three (3) years, has continuously asserted that the amount of rock drilled and blasted by Explo and afterwards by Garlam on behalf of Explo amounts to 2,936,972 cubic meters or more.

After submittal of the production figures in the Capo Report, at the Special Master proceedings, Garlam has changed his position as to the amount of rock blasted by Explo and by Garlam on behalf of Explo to be credited to Explo, in which undoubtedly the amount of rock removed by ripping in accordance with the capabilities of the heavy equipment was

considered. Garlam now is interpreting theoretically the seismic studies, the probable ripping capabilities of the equipment bought for the project and after various assumptions and mathematical approaches assuring that only 1,830,513 cubic meters of rock was drilled and blasted, contrary to previous position, formally expressed in Capo Report.

Garlam did not mention in any of his recent Motions how the material ripped was measured in the field or if the Subcontract requirements of cross sections measurement were observed.

As to Garlam continuous discussion of Exhibit 4 - Summary of Production, as a certified document by Engineer Da' Silva, it should be cleared that during the proceedings Engineer Da' Silva refused to admit that he had accepted or approved

the so called amount of rock drilled and blasted, not a Highway Authority contract item. Engineer Da' Silva simply certified that the mathematical procedure followed for the calculation was appropriate.

November 15, 1976
CAPO REPORT - EXHIBIT 1

Total amount of rock, credit Explo $1,193,847 that is 2,936,972 cubic meters of rock ($0.51 plus 322,574 ln ft presplitting - $0.70) of a total Unclassified Excavation of 4,396,116 cubic meters, 1,459,143 was loose material and 2,936,972 represented rock, seismic study shows 1,770,928 mt of rock material 8000 ft per second or less.

EXHIBIT 6

Cross Sections
Calculations 2,936,972

March 18, 1976
EXHIBIT E, VOLUME OF
ROCK-CALCULATIONS BY GARLAM

Shown in cross sections 2,936,972 by computer and 3,005,981 by planimetry.

November 12, 1976
MORALES BRIEF

As to Exhibit G the total rock blasted amounts to 3,005,981 meters (page 41).

Explo Post Hearing Memo 3,005,981

April 28, 1977
MOTION FROM GARLAM

Da Silva was able to certify the exact volume of rock blasted in the project, 3,005,984 by planimetry and 2,936,972 cubic meters by computer.

May 2, 1977
MOTION LIQUIDATION OF EXPLO SUBCONTRACT BY GARLAM

Volume of rock executed by Explo, planimetry 3,005,984 cubic meters, or 2,936,972 by computer.

June 22, 1977
EXHIBIT #1, TOTAL COST TO COMPLETE PROJECT, CAPO REPORT

Production by months and cumulative, reflected that after considering amount-cost of presplitting, amounts of rock blasted 2,936,972 cubic meters.

EXHIBIT $ - Volume or Rock
2,936,972

EXHIBIT D - Volume of Rock

PLANIMETRY 3,005,986

COMPUTER 2,936,972

Uly [sic] 12, 1977
REPORT FOR ADMISSION OF FACTS UNDER RULE 36

Explo entitled to a credit of $1,723,295, that is Explo entitled to 321,634 ln ft of presplitting at $0.70, the rock blasted will amount to 2,936,972 cubic meters.

Garlam blasted 2,901,929 and Explo 35,042 of usable material for a total of 2,936,972 cubic meters.

September 27, 1977
DEPOSITION MIGUEL ANGEL CORDERO

Cordero certified as correct the 2,936,972 cubic metes [sic] of rock on Exhibit #1, Capo Report, indicating that no reclamation was presente [sic] to the Highway Authority for the overrun on rock.

October 19, 1977
DEPOSITION OF ENGINEER DA SILVA

During all the proceedings Garlam tried to get a positive answer from Da Silva that the cross sections and calculations of blasted rock signed by him showed 2,936,972 for rock by computer and 3,005,981 by planimeter.

October 17, 1979
INITIAL STATEMENT BY GARLAM

As Explo been credited with $1,193,847 at a rate of $0.51 per cubic meter of rock and $0.70 per ln ft for presplitting, rock blasted considered amounts to 2,936,972 cubic meters.

EXHIBIT E- Total amount of rock moved was 2,936,972, were removed in the entire project, including material removed by Garlam prior to May 1971, material removed by Explo and material removed by Garlam after Explo breach. Total amount of rock in project amounts to 2,936,972 cubic meters which 1,959,402 was blasted and the other ripped.

In the consideration of amount or rock blasted by Explo, and Garlam on behalf of Explo, the Special Master accepted the production figures in the Capo Report, Garlam basic piece of evidence in the case, amounting to a total production of figure of $1,723,295.10, as Garlam reported formally to Explo.

Considering that Explo, and then Garlam in behalf of Explo, presplitting

figure amounts to 321,624 ln ft, Explo is entitled to a credit of $225,136.80. After deducting the $225,136.80 credit for presplitting from the final-total production credit of $1,723,295.10, results in $1,498,158.30. Dividing this figure by $0.51 per cubic meter, contract price for blasting it reflects that the total amount of rock blasted and formally credited to Explo amounts 2,937,565 cubic meters.

The amount of rock drilled and blasted originally by Garlam, 58,803 cubic meters, should be added to the 2,937,565 figure, totalling 2,996,368 cubic meters of rock drilled and blasted within the original contract limits of the project.

Special Master concluded that Explo drilled and blasted 70,086 cubic meters, Garlam in behalf of Explo drilled and

blasted 2,867,479 cubic meters and Garlam originally blasted 58,803 cubic meters, totalling of 2,996,368 cubic meters of rock drilled and blasted within the original contract limits of the project.

As to presplitting Explo is credited with 4909 ln ft, Garlam on behalf of Explo with 316,715 ln ft and Garlam originally 850 ln ft, for a total of 322,474 ln ft.

B. THE QUANTITIES OF ROCK DRILLED AND SHOT (MASS-BLASTED AND PRE-SPLITTING) OUTSIDE THE ORIGINAL CONTRACT LIMITS--e.g., WHERE SLOPES OR GRADES WERE CHANGED OR DIFFERENTE FROM THOSE SHOWN ON THE ORIGINAL CONTRACT DRAWINGS

Garlam has asserted tha 285,422.86 cubic meters were drilled and blasted, inconsisten with recent position that the ____ movement resulted from landslides.

Garlam however, "after the landslide occurred, removed the material and hauled it to the embankment and was paid by the Highway Authority for this work of moving the material to the proper embankment." Page 25 Exceptions to the Preliminary Report of the Special Master.

July 12, 1977

ANSWER TO INTERROGATORIES SIGNED BY GARFFER, SENIOR

"Explo was credited with 288,422.98 cubic meters of over cuts in certain areas for which Garlam claimed and was paid as Unclassified Excavations."

September 27, 1977

DEPOSITION MIGUEL ANGEL CORDERO

"288,000 cubic meters was paid by Highway Authority as Unclassified Excavations, so was credited to Explo for "drilling and shooting."

October 18, 1977

DEPOSITION CELESTINO MORALES

"Garlam blasted 288,424.98 cubic meters of overcuts that were paid at a rate of $2.03 as Unclassified

Excavations to include the drilling of the holes the packing of the holes, the explosive, the primacord, dynamite sticks and whatever other items or material were required, the cleaning of the station and the loading and hauling the material to the field side. These overcuts resulted in $585,498.65." (7)

In addition to this amount, Garlam was paid on the basis of force accounts for additional overcuts that resulted from landslides. (8)

October 19, 1977

MOTION SUBMITTING ADDITIONAL EVIDENCE BY GARLAM

Garlam received payment for 288,422.98 cubic meters of overcuts for a total of $585,468.65.

March 12, 1979

CIVIL CASE 76-1431, GARLAM vs. HIGHWAY AUTHORITY EXHIBIT #1

ITEM 23

Garlam executed a cut out of the lines of design of 288,422.98 cubic meters. The Highway Authority paid the excavations as Unclassified Excavations, $2.03, when it should be considered as "borrow."

DEPOSITION ENGINEER DA SILVA

Overcut amount to about 288,000 cubic meters, Garlam is asking to consider same as "borrow" and not as Unclassified Excavations.

The 288,000 cubic meters are included in the total figure or amount of borrow, 1,095,000 cubic meters.

Special Master concluded that as previously accepted formally, Garlam drilled and blasted 288,422.98 cubic meters of rock outside of the original contract limits and that this amount of blasted rock was not included in Capo Report Figures.

C. THE QUANTITIES OF ROCK DRILLED AND SHOT (MASS BLASTING ONLY) AS BORROW MATERIAL.

Aguirre Borrow Pit - 63,999 cubic meters of rock blasted, no presplitting.

D. THE QUANTITIES OF ROCK DRILLED AND SHOT (MASS BLASTING AND PRESPLITTING) BY EXPLO.

According to documents presented during the proceedings in Explo-Garlam Case, Garlam has continuously asserted that Explo drilled and blasted 70,086 cubic meters of rock and 4909 ln ft of presplitting.

October 17, 1979
INITIAL STATEMENT BY GARLAM

October 30, 1979
SECOND COURT HEARING - SPECIAL MASTER

November 12, 1979
POST HEARING MEMORANDUM TO SPECIAL MASTER BY EXPLO

November 14, 1979
MEMO OF GARLAM TO SPECIAL MASTER

November 28, 1979
REPLY MEMO TO SPECIAL MASTER BY EXPLO

Special Master, after considering the various reports on problems caused by rock size larger than 15 inches, as requested on Subcontract, concluded that Explo should receive payment for 70,086

cubic meters of rock and 4909 ln ft of presplitting.

E. THE QUANTITIES OF ROCK DRILLED AND SHOT (MASS BLASTING AND PRE-SPLITTING BY GARLAM ENTERPRISES BEFORE EXPLO BEGAN WORK

Garlam drilled and blasted 58,803 cubic meters of rock and 850 ln ft of presplitting.

October 18, 1977
CELESTINO MORALES DEPOSITION

October 17, 1979
INITIAL STATEMENT OF GARLAM

November 12, 1979
POST HEARING MEMO TO SPECIAL MASTER BY EXPLO

November 14, 1979
MEMO OF GARLAM TO SPECIAL MASTER

November 28, 1979
REPLY MEMO TO SPECIAL MASTER BY EXPLO

October 30, 1979
SECOND COURT HEARING SPECIAL MASTER

Special Master concluded that Garlam drilled and blasted 58,803 cubic meters of rock and 850 ln ft of presplitting, before Explo began work.

F. THE QUANTITIES OF ROCK DRILLED AND SHOT (MASS-BLASTING AND PRE-SPLITTING) BY GARLAM AFTER EXPLO CEASED WORK

As discussed fully in Paragraph A "The Amount of Rock Drilled and Shot Within the Original Contract Limits on the Project," Garlam, after Explo ceased work, drilled and blasted 2,867,479 cubic meters of rock and 316,715 ln ft of presplitting.

G. THE COST TO GARLAM OF DRILLING AND SHOOTING ROCK (MASS BLASTING AND PRESPLITTING) WITHIN THE ORIGINAL CONTRACT LIMITS:

a) BEFORE EXPLO BEGAN WORK

With the data available it is impossible to determine the cost of drilling and blasting by Garlam before Explo began work, specially since prior to Explo Subcontract, Garlam did not need to separate costs of aspects included in Item 4 - Unclassi-

fied Executions of Highway Authority Contract.

b-c) AFTER EXPLO CEASED WORK AND UP TO THE POINT IN TIME WHEN THE QUANTITY OF BLASTED ROCK EXCEEDED ONE AND ONE HALF MILLION CUBIC METERS (INCLUDING QUANTITY PERFORMED BY EXPLO AND BY GARLAM BEFORE EXPLO BEGAN WORK); EXCEEDED TWO MILLIONS CUBIC METERS

It is nearly impossible to determine with accuracy the cost of drilling and blasting the first 1.5 millions of cubic meters of rock, specially because drilling and blasting does not constitute a Contract Item in the Highway Authority Contract and is only a part of Item 4 - Unclassified Excavations. Particular stations at the same instance were in different constructions stages such as staking, drilling-

presplitting, blasting, clearing, therefore not ready for measurement. Also indirect costs are impossible to account in specific stage, without having detailed information.

d) AFTER EXPLO CEASED WORK AND TO THE COMPLETION OF THE PROJECT

A detailed analysis of the Capo Report permitted the Special Master to reach the following conclusions:

RECONCILIATION OF ACCOUNTS

A- MATERIAL AND SERVICE COSTS

Expenses incurred for materials and equipment needed to perform the work by Garlam in drilling and blasting of Aguirre Borrow Pit and the 288,422.98 cubic meters of

rock from outside the contract limits, can not be charged against Explo. See Paragraph B and C Order of Reference.

Charges not attributable against Explo.

B- CAPITAL INTEREST CALCULATIONS

Considering production accrued against direct cost to complete project.

Exhibit of Special Master SM 3

C- HANDLING AND OTHER EXPENSES

Exhibit of Special Master SM 4

D- CREDIT TO EXPLO FOR AMOUNT OF ROCK DRILLED AND BLASTED, AND PRESPLITTING

Refer to Paragraphs D and F

Order of Reference

E- LEGAL CONTROVERSY WITH INGERSOLL RAND CASE

Exhibit of Special Master

SM 5

F- LETTER OF CREDIT - CITY BANK $250,000

Exhibit of Special Master

SM 6

G- AMOUNT INVESTED IN HEAVY CONSTRUCTION EQUIPMENT FOR THE PURPOSES OF ACCELERATING THE COMPLETION OF WORK

Refer to Paragraph N Order

of Reference

H- DELAYS DAMAGES

Refer to Paragraph H Order

of Reference

TOTAL COST TO COMPLETE	$3,560,322
Ingersoll Rand Court Claim, add	30,897
Letter of Credit-City	

Bank, add	19,062
TOTAL COST TO COMPLETE, Revised	3,610,281
CREDIT TO EXPLO, deduct	1,723,295
NET ADDITIONAL COST TO COMPLETE	1,886,986
15% FOR OVERHEAD AND PROFIT, in according with Subcontract	283,048
TOTAL AMOUNT TO GARLAM	$2,170,034

H. THE DELAY, IF ANY, IN THE PERFORMANCE OF THE WORK BY EXPLOSIVES CORPORATION OF AMERICA AS WELL AS THE RESULTING DELAY ATTRIBUTABLE TO EXPLO.

Garlam is demanding from Explo, as penalty or liquidated damages, the sum of $273,500.00 related to time delay of 547 days. Garlam determined this delay period under the theory that Garlam was not able to pick up the time schedule of the development of the project. Explo position is that the entire project was so delayed and disrupted by faulty design, changed conditions and other fac-

tors, which are not the responsibility of Explo.

Highway Authority Contract Documents entitled the Contractor to extension of time for completion because of increased contract cost, suspension of work, unforeseen causes, causes beyond the control of the Contractor and other causes.

Exhibit 30 consists of an analysis by Mr. Miguel Angel Cordero determining that the cost to Garlam of reconditioning the stations worked by Explo amounted to $932,124.78. The Special Master analized [sic] Payment Certification for Unclassified Excavations covering the five (5) stations worked by Explo and finished by Garlam, showing that without valid reasons the stations were not worked continuously, with a markedly [sic] time

period between certification, for example:

STATION 235+00

By late 1972, 86% of a total of 331,918 cubic meters were certified, while Payment Certificate #34, dated November 1973, is limited to a final 1% of the total amount.

STATION 247+00

By June, 87% of the station was cleaned. In the next nine (9) months an additional 4%, in the next six (6) months 4%, while in two (2) more months the last 5% was finished, that is November 1973.

Accordingly, Garlam in Civil Case 76-1431 Garlam vs. Highway Authority is demanding from the Highway Authority a bonus or compensation for completion ahead of time, amounting to 1959 calendar

days at $2,300 per day, $4.5 millions for the following causes:

SUSPENSION OF WORK	134 days
Official suspension of work by Highway Authority Officials	
UNFORESEEN CAUSES	353 days
Extraordinary rainfall according to Official Reports of the U.S. Weather Bureau	
CAUSES BEYOND CONTROL OF CONTRACTOR	968 days
Various causes such as labor strikes	
INCREASES CONTRACT VALUE	58 days
Time allowances increased in the same ratio as the total cost of the contract	
OTHER CAUSES	1633 days
Time required for Extra Work Orders demanded and negotiated with Highway Authority	
TOTAL	3148 days
ORIGINAL CONTRACT TIME	600 days

EXTENSIONS GRANTED 1522 days

GARLAM DEMANDED ADDITIONAL TIME 1959 days

TIME EXTENSION DEMANDED BY GARLAM

It should be clarified that Explo Subcontractor responsibility for the drilling and blasting phase, was completely subordinated to the construction process established by Prime Contractor; due to the fact that for Explo to start doing any work depended upon the cleaning-grubbing-ripping-removal of the overburden, cleaning and grubbing to hard rock-staked out surveying by Prime Contractor. After the drilling and blasting, Explo continued to be fully subordinated to the Prime Contractor, responsible for the dozing-cleaning of the blasted material and final surveying of cross sections for payment purposes.

Prime Contractor fully controls the development of the project and specially the timing of all construction phases.

Explo Subcontract and Approval of Subcontractor by Highway Authority established that "Subcontract is approved under the understanding that Sub-Contractor will meet all the requirements of the Contract. Subcontractor shall be bound by any changes or alterations ordered by the Owner in the work under the Agreement in the General Contract, Specifications, General and Special Provisions, or in the amount or character of said work to the same extent that the Contractor is bound thereby, the payments to the Subcontractor to be adjusted accordingly."

Considering that according to these provisions Explo is entitled to time extensions, using the figures and argu-

ments by Garlam in Civil Case 76-1431, as presented by Explo, the corresponding extension of contract time related to the period of June 1971 to November 1972, that is the Explo Subcontract period, the contract time should be increased 689 calendar days, exceeding the 547 days delay penalty demanded by Garlam, and accordingly, in the total contract time.

"As a rule, the Courts will refuse to enforce contract provisions for liquidated damages for delayed performance where the other party to the contract has been responsible for party of the delay. The reason for this rule is that the Courts will not attempt to apportion the delay."

"The rule is well settled that where the work to be performed by the builder cannot be performed until the other work provided to be done by the owner or his

employees is finished, the failure by the latter to complete their work in season to enable the builder to end his within the time limited by the contract is a sufficient cause for his delay beyond the agreed period of completion."

"United States v. Cunningham, 125 F (2d) 28. "The contract in question contained a provision giving the right to liquidated damages and also contained a provision giving the United States, upon failure to perform in time, the right to take over the work and complete it and hold the Contractor for any excess cost."

"The government took over the work after the date for completion set forth in the contract and the Court held that the government by such act waived the right to collect liquidated damages. The Court in its opinion states: "We think these rights are alternatives. The arti-

cle states that if the Government does not terminate the right of the Contract to proceed, then the Contractor shall continue the work and liquidated damages may be assessed."

"But in this case the United States did terminate the contract and did take over and complete the work and did collect the excess costs. Having chosen this method of completing the contract, they cannot also claim the other alternative of liquidated damages. Similar provisions in government contracts have been consistently so construed by the Court of Claims. See particular, Fidelity & Casualty Co. of New York vs. United States, 81 Ct. Cl. 495; Commercial Casualty Ins. Co. v. United States, 83 Ct. Cl. 367. In the first named case the Court of Claims said: "The defendant elected to choose the first of these

alternatives and when that decision was made the second alternative disappeared from the picture. It was thereafter mere surplusage. Upon the termination of the contract no liquidated damages could be charged to or be recoverable from the Contractor." 81 Ct. Cl. p. 502."

The Special Master considers that Explo work responsibilities were totally subordinated to the Prime Contractor remainder of the work, that Explo Subcontract had to meet all the requirements of the Garlam-Highway Authority Prime Contract and that Explo was entitled to all time extensions related to the development of the project such as official suspension of work by Highway Authority officials-extraordinary rainfalls-labor strikes and others.

For the above reasons, Explo Subcontractor should not be penalized for delay damages.

I. THE TIME, IF ANY, THAT THE PROJECT WAS PROLONGED BY ACTS OR OMISSIONS OF THE HIGHWAY AUTHORITY

The Contract Time of the project, originally 600 calendar days, was formally extended to 1522 more days as described in previous Paragraph I. In Civil Case 76-1431 Garlam vs. Highway Authority, considering the various causes for time extension in contract documents, Garlam is demanding that contract time be extended some additional 1959 calendar days and as a bonus or compensation for completion ahead of time, be allowed $4.5 millions, at $2,300 per day.

J. THE TIME, IF ANY, THE PROJECT WAS PROLONGED BY CHANGES OR CHANGED CONDITIONS OR EITHER OF THEM

The 41 original construction items of the contract were increased to 98 construction items, 30 work orders and 9 change orders were ordered and approved by the Highway Authority, the original construction time of 600 calendar days was officially increased 1552 calendar days and the project was liquidated by the Highway Authority for $19,499,579.16, that is 31% over original contract cost. On top of this amount Garlam is demanding from the Highway Authority some additional $15.8 millions, for interest and lawyers fees.

Undoubtedly the project was delayed because of [f]aulty design assumptions resulting in an unbalanced project as to cut and fill, all contributing to the

delays and cost increase of the contract work.

K. THE TIME, IF ANY, THE PROJECT WAS PROLONGED BY ACTS OR OMISSIONS OF GARLAM ENTERPRISES CORPORATION

On the revision of Daily and Activities Reports from the Highway Authority, and documentation presented in the proceedings, there is evidence of continuous broken equipment and demands from Project Engineer for more appropriate equipment needed for accelerating earth work, requiring Garlam to invest on [sic] several pieces of equipment with greater capability, required for the project. See Paragraph N Order of Reference.

L. THE ACTUAL AND NECESSARY ADDITIONAL COST REASONABLY INCURRED BY GARLAM ENTERPRISES CORPORATION IN ORDER TO COMPLETE THE WORK REQUIRED OF EXPLOSIVE CORPORATION OF AMERICA BY THE SUBCONTRACT BETWEEN PARTIES

Paragraph G Order of Reference shows that Garlam Total Cost to Complete the

drilling and blasting phase amounts to $3,610,281.

M. THE AMOUNT OF INTEREST, IF ANY, TO BE PAYABLE TO GARLAM BY THIRD PARTY DEFENDANTS

As discussed in Exhibit of Special Master SM 3, capital interest was accrued to direct cost to complete project, after considering the corresponding accrued production, amounting to $253,143.

N. THE AMOUNT INVESTED IN ADDITIONAL EQUIPMENT FOR THE PURPOSES OF ACCELERATING THE COMPLETION OF THE WORK

Garlam is demanding from Explo $819,861.81 for the depreciation of various heavy equipment track dozers bought during the development of the project, investing $1,465,161.46. Garlam claimed that the equipment was bought to accelerate the completion of the work in order to be able to catch up with its normal rate of production required under the

agreement, for the purpose of completing the work on time and avoid the delay penalty of $2,300 per day required on Prime Contract, as compared to only $500.00 per day in Explo Subcontract.

Explo claimed that Garlam bought the equipment to expedite the work due to the great number of changes and extras required by the Highway Authority faulty project design assumptions and that the equipment was bought long before Garlam ever claimed any delay. Also, that Highway Authority daily reports-notes show that the Engineer called continuous attention to Garlam about delays on the project, without mentioning drilling and blasting, due to amount-capacity-capability of equipment on project, damaged equipment, strikes, pouring of box culverts, concrete delivery. . .

Before discussion by the Special Master the following notes and testimonies should be mentioned.

CONTRACT SPECIFICATIONS - ARTICLE 8-4

> All machinery or equipment owned or controlled by the Contractor shall be of sufficient size and in such mechanical conditions as to meet the requirements of the work and no [sic] produce a satisfactory quality of work. The Engineer may order the removal and require replacement of any unsatisfactory equipment.
>
> Failure of the Contractor to provide adequate and satisfactory equipment may result in annulment of the contract. The measure of capacity of machinery and equipment shall be its actual performance on the work.

January 1976

DEPOSITION ENGINEER DA SILVA

> "Well, in my opinion, at that time the equipment was not at its best conditions." (682)
>
> "Think that with the equipment used, Garlam will not finish on time." (683)
>
> "During 1971, after the access roads to the work were constructed, we saw that additional equipment was necessary, and we also talked about that

with the Garlam people and they finally supplied us with the equipment we had required, including the bulldozer HD-41, which are excellent." (686)

"During the period we only counted the equipment we had on the field, not what they had in the shop. (679) It may have included it but generally it was the equipment which was out of order."

June 22, 1977

EXHIBIT #1, TOTAL COST TO COMPLETE PROJECT, CAPO REPORT

List of Equipment purchased to accelerate work	$1,465,161.46
Some equipment was ordered on September 20, 1971, and received on November 13, 1971 as certified by Garlam, other in 1972 and 1973.	

EXHIBIT #7

4 Allis Chamber Track Dozer, HD-41	$ 685,000.00
2 Allis Chamber Track Dozer, HD #21B	$ 128,000.00
2 Michigan Track Dozer	$ 154,000.00
TOTAL INVESTMENT	$1,465,161.46

Depreciation of $ 819,861.81

July 12, 1977

REPORT FOR ADMISSION OFF [sic] FACTS UNDER RULE 36

Garlam purchased equipment for $1,465,161.46 for the purpose of accelerating work.

August 10, 1979

CIVIL CASE 76-1431 - GARLAM VS. HIGHWAY AUTHORITY

Original Estimate - Unclassified Excavations cu mts	4,468,000
Total Volume of Earth Work on Project cu mts	6,042,027
Swell Factor, 20%, cu mts	1,208,405
Total Material Worked, cu mts	7,250,432
Borrow Material Required cu mts	1,095,050

Garlam invest over $2.0 millions in heavy equipment in order of accelerating project and having the benefit of the bonification.

The preamble of this document GENERAL DESCRIPTION OF THE DEVELOPMENT OF CONSTRUCTION PROJECT, includes notes on

the increases in contract costs from the original $13.49 to $19.50 millions in contract liquidation, while Garlam is demanding from the Highway Authority an additional $15.8 millions, indicating earth work amounting to 6.04 millions cubic meters and with the 20% swell factor, increased to 7.25 millions cubic meters, as compared to the original 4.468 millions cubic meters on the contracted balanced project. Contrary to above figure in the drilling and blasting phase, the Special Master is recommends [sic] the liquidation of Explo Sub Contract at less than 3.0 millions cubic meters of rock drilled and blasted, within the original contract limits.

On Paragraph H of the Order of Reference, the Special Master emphasized the dependence or subordination of the Drilling and Blasting Subcontractor to

Prime Contractor, in its responsibility of Unclassified Excavations and borrow in the project.

Contract Documents clearly require the responsibility of Contractor to provide adequate and satisfactory equipment of sufficient size and in such mechanical conditions as to meet the requirements of the work, establishing that the Highway Authority may order the removal and replacement of any unsatisfactory equipment. On this token, during the proceeding of the case and analisis [sic] of Highway Authority Daily and Activities Reports, it was shown that the Authority required more capable equipment to take care of any equipment breakdown or inactive reason for which Garlam decided to buy, as it bought, before Explo breached the contract, several pieces of equipment with greater capability than the original

equipment. None of the required was related to the drilling and blasting phase.

On Civil Case 76-1431 Garlam vs. Highway Authority, Garlam justified the equipment investment as needed for accelerating the project and obtaining the benefit of the bonus or compensation for finishing the project ahead of time, while the Explo vs. Garlam Case stated that the equipment was bought just to catch up with the so called delay caused by Explo, who only worked 150 days of the total 2122 days contract-time, without taking into consideration the additional 1959 days demanded by Garlam from the Highway Authority.

Considering all the information presented in the proceedings, it is the Special Master's opinion that the heavy equipment was bought because of the

requirements by the Highway Authority and the need of the Prime Contractor for the efficient development of the entire project without any direct reference to the drilling and blasting phase. Special Master, therefore concluded that there are not valid reasons for charging the cost or amount of depreciation of the heavy equipment to Explo Subcontractor.

O. ANY AND ALL OTHER FACTS WHICH THE MASTER FINDS NECESSARY OR PROPER TO REACH A DETERMINATION AS TO AMOUNTS, IF ANY, THAT MAY BE DUE AND OWING GARLAM ENTERPRISES

Preceding Paragraphs of Order of Reference covered fully the Total Cost to Complete the Project and the amount of money credited to Garlam Enterprises Corporation.

Court should decide on any interest due on the Total Cost to Complete, Court

costs, attorneys, fees and such Order as the Court may deem proper.

The Master is greatly indebted to the Court Secretariat [sic] personnel, Reporter and Counsels for the parties, for their cooperation and assistance in the completion of this Report.

At San Juan, Puerto Rico this 24 day of April 1980.

ULISES BARROS LOUBRIEL
SPECIAL MASTER BY
DESIGNATION

NOTE:

Report filed with the Clerk of the Court, together with all Documents and Exhibits.

70839

EXPLO VS. GARLAM

TOTAL COST TO COMPLETE PROJECT--

CREDIT TO EXPLO

FINAL ANALYSIS BY SPECIAL MASTER

EXHIBIT OF SPECIAL MASTER SM. 2

. . .

D. CREDIT TO EXPLO $1,723,295

In accordance with Paragraph D, Order of Reference, Explo should be credited for 70,086 cubic meters of rock blasted at $0.51 per cubic meters, $35,744, and 4909 ln. ft. of presplitting at $0.70, $3,436, a total amount of $39,180.

In accordance with Paragraph F, Order of Reference, Explo should be credited for 2,867,479 cubic meters of rock at $0.51, $1,462,414, and 316,715 ln. ft. of presplitting at $0.70 per ln. ft., $221,700, a total amount of $1,684,115.

As to the preceding paragraphs, Explo should be credited for $1,723,295, which represents the Accrued Production Figure in Capo Report.

. . .

72443

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF PUERTO RICO

EXPLOSIVES CORPORATION OF AMERICA,	)	
Plaintiff	)	CIVIL 72-0001CC
vs	)	
GARLAM ENTERPRISES CORPORATION & FEDERAL INSURANCE COMPANY	)	
Defendants	)	

OPINION AND ORDER

The construction of that part of the Las Americas Expressway that traverses through the rugged terrain of the central mountains of Puerto Rico generated this case which has unfortunately dragged on for more than a decade and which serves to prove that it is easier to build bridges between mountains than bridges between minds. On January 3, 1972,

Explosives Corporation of America (Explo), a Washington corporation, filed this complaint alleging breach of contract by its prime contractor Garlam Enterprises Corporation (Garlam), a Puerto Rico corporation, and its surety, Federal Insurance Company, Inc. Garlam had been hired by the Puerto Rico Highway Authority (PRHA) to build that part of the San Juan-Ponce Expressway which passed through an area of the Cayey Sierra called Las Palmas-Cerro de los Cielos (Project Number AC-52(R)12(70)). Garlam, in turn, subcontracted Explo for the pre-splitting and blasting operations required by the project. On July 6, 1972, Garlam answered the complaint and counterclaimed, also for breach of contract, against Explo and its surety General Insurance of America. The issue of liability was determined by Judge

W. T. Bootle[1] in an opinion and order of April 4, 1976, later amended nunc pro tunc (Opinion). Judge Bootle made the following findings relevant to the liability issue.[2]

During the period of approximately five months that Explo worked on the project "it did not comply with the interpretation of Garlam as to the maximum rock size" of the rock debris left after blasting. According to the court's findings, the contractual requirement was that the rock fragments remaining after blasting could not exceed fifteen (15) inches in diameter. The court also found that "initial personnel of Explo in this project were not very proficient in blasting techniques," thus, many erratic

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1/ Senior Judge for the Middle District of Georgia, sitting by designation.

2/ Additional detailed findings of fact can be found in this opinion.

decisions were made; and that Garlam was "entitled to direct the work of Explo from day to day." Explo was found liable to Garlam because the evidence failed to establish any substantial nonpayment by Garlam so as to justify Explo's deficient performance and its midproject abandonment. The measure of Explo's liability was "the actual and necessary additional costs reasonably incurred by Garlam in order to complete the work required of Explo by the subcontract." The Court, however, was quick to indicate the limits of its holding and left for determination at the second trial on the issue of damages, the following matters: the deduction made by Garlam on the amounts due to Explo in compensation for the

oversize rock fragments;3/ the amount owed to Explo for the work it rendered;4/ the amount of damages chargeable to Explo, if any, due to late completion of the work; whether any delay penalty may be charged to Explo; the interests on the amounts; and whether General Insurance of America's liability is limited to the

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3/ Under the circumstances due to the oversize of the rock fragments, the suggestion of an allowance of only 50% by Garlam was not an unreasonable one, and constituted a good faith gesture on its part. This finding shall in no sense be controlling or binding during the second trial of this case in which the issue of damages will be primarily and directly involved. . . ." (Opinion at p. 6).

4/ "Explo is entitled to be credited in exchange for the work done by it . . . on the basis of the agreement . . . at the rate of 51 cents per cubic meter of blasted rock and 70 cents per linear foot of pre-splitting." Id.

penal sum of $1,230,000.00 named in the payment and performance bond.5/

The discovery proceedings that ensued demonstrated that the determination of damages was a task of olympic proportions that required highly technical expertise in engineering. The court's suggestion of appointing Ulises Barros as Special Master under Rule 53 Fed. R. Civ. P. to determine the damages caused by Explo's breach was accepted by the parties and an Order of Reference was entered on September 12, 1979. According to this order, the Special Master was to aid the court in assessing the amounts, if any, which may be due to Garlam. The court suggested that the Special Master make

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5/ This question was decided by Summary Judgment of October 21, 1977, limiting liability only up to the penal sum mentioned in the bond, that is, $1,230,000.00.

findings on the following facts: the quantities of rock drilled and shot within and outside the original contract limits, or used as borrow material and the quantities and cost of these activities by Explo and Garlam at different times throughout their participation in the project. Findings on the reasons for delay and the entities responsible for it, the amount invested in additional equipment and any other findings that the Master deemed necessary, were also suggested. The Order of Reference imposed the cost of compensation of the Special Master on Explo.

The Special Master held two days of hearings where the parties presented their testimonial and documentary evidence. A preliminary report was filed and the parties presented their opposition and comments. Garlam claimed that

the Preliminary Report favored Explo, violated the guidelines of Judge Bootle's opinion and the Order of Reference, made findings without being supported by the evidence on record and contained simple mathematical errors. Explo contested the Preliminary Report as failing to demonstrate that Garlam fulfilled its burden of proof so as to justify the award of damages. On April 24, 1979, the Special Master submitted his final report (Report) to the Court which considered the previously filed objections along with the determination of damages. The Special Master found that Garlam's damages amounted to $2,170,034.00 plus $253,143 for interests. The Report addresses the findings suggested by the Order of Reference and determines that Explo's work consisted in blasting 70,086 cubic meters and pre-splitting 4,909 lin-

ear feet at the stipulated contract price of 51 cents per cubic meter of blasting and 70 cents per linear feet of pre-splitting for a total of approximately $39,180.00. This sum was set off by the Special Master against Explo's debt to Garlam and included as a "credit" to Explo. Also credited were the amounts corresponding to Garlam's work within the original contract limits before and after Explo's performance and not attributable to Explo's breach. This sum, together with the amounts set off for Explo's work, amounted to $1,723,295.00. The Special Master then subtracted this amount from the total cost to complete ($3,610,281.00) this phase of the project and fixed the sum of $1,886,986.00 as the additional cost to complete attributable to Explo's breach. To this he added the 15% for overhead and profit stipulated in

the subcontract, plus $253,143.00 for capital interests accrued to the direct cost to complete the project, and arrived at the sum of $2,423,177.00 as the total amount of additional costs incurred by Garlam which were related to Explo's conduct and which constituted the damages suffered by Garlam due to Explo's breach of contract.

We take the time to describe these totals to clear any confusion that the parties may have due to the highly technical descriptions contained in the report. The main confusion that we perceive from the parties' briefs stems from the misconception that Garlam was entitled to recover all delay and excess costs incurred in the project. The Master considered that several items claimed by Garlam were not attributable to Explo's breach. There were many fac-

tors affecting the project and resulting in extra cost[6/] which the Special Master took the effort to isolate to determine which were attributable to Explo. Although this was certainly the most difficult way of approaching the task, it was undoubtedly the only way the determination of damages could have been made in harmony with the dictates of the Opinion, the Order of Reference and the Law of contractual damages in Puerto Rico. It would have been clear error for the Master to determine that Explo was liable for all additional and regular costs in completing the entire project which entailed, not only pre-splitting and

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6/ The construction of this part of the expressway was originally contracted at $13,489,412.39 to be finished in 600 consecutive calendar days. The final project took 2152 days to complete and Garlam is claiming $35,328,410 as final cost.

blasting part of the mountains, but also the construction of bridges and roads and other general construction work required by this type of highway. Such determination would have been not only manifestly erroneous but would have created an obvious inequitable situation by permitting Garlam to recover twice the amounts for the same item of work, once from Explo and again from the PRHA. Although Garlam made repeated efforts to cloak its relationship with PRHA and its pending claims, the Special Master could not be blind to this reality. With this situation in mind, we now turn to the parties' respective oppositions to the Report.

Besides its challenge to Garlam's burden of proof on damages, Explo contends that the Report now demonstrates that the amounts owed to it by Garlam were substantial and that Judge Bootle's

opinion is premised on a mistaken assumption and must be overruled. Garlam's opposition consists basically of the same arguments previously voiced in addition to a "Due Process" claim. The violations to the Due Process Clause of the United States Constitution claimed consist of an alleged "private and secret" conversation that the Master conducted with a witness during a recess in the proceedings and of his consideration of evidence not on record. The court held a hearing on June 3, 1981 to address this matter where both Parties had the opportunity to present evidence and to question the Special Master. We shall first consider the "due process" claim.

Garlam's major source of concern on the allegedly extraneous pieces of evidence considered by the Special Master, is the record of a related case which it

filed in the Superior Court of Puerto Rico[7/] against its contractor, the Puerto Rico Highway Authority (the PRHA case). It contends that the Special Master based many of his conclusions on documents and pleadings filed in the PRHA case. It also points out that Explo attached to its post-hearing memorandum several documents (Exhibits V-X) that had not been previously submitted as evidence and that the Special Master relied on them to support his findings and conclusions. Explo's position is that these documents are mere summaries of others already in evidence which were submitted with the post-hearing memorandum for the sole purpose of supporting its arguments. The documents consist of: Exhibit V, Unclassified Excavations--a chart com-

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7/ Civil Case No. 76-1431, Garlam v. PRHA.

paring quantities of rock certified by Garlam with quantities of rock certified by the PRHA; Exhibit VI, another chart comparing discrepancies in the cross sections and hatch lines; Exhibit VI-A, seismic studies--comparative analysis of graphs and certifications of removed rock; Exhibit VII, Garlam's brief in the PRHA case; Exhibit VIII, samples from the daily reports; Exhibit IX, reports showing problems with Garlam's equipment; and Exhibit X, breakdown of repair and service to equipment charged by Garlam to Explo. Garlam also contends that during a recess in the proceeding the Special Master approached Engineer Da Silva, a witness, and spoke to him for about twenty minutes in the hallway of the courthouse.

At the hearing before us the Special Master, under oath, indicated that these

exhibits were not used to support his conclusion, since they were only summaries of documentary evidence presented previously during the proceedings before him. These summaries, together with similar ones prepared by the Master, were used to aid him in sorting out and organizing the innumerable data already on record. He indicated that, except for the typing, all the analysis, studies, examinations and conclusions were made solely by him and without resort to any outside information or help. Upon Garlam's inquiry, the Master stated that several textbooks dealing with road construction and explosives were consulted to aid him in his analysis. As to the PRHA case, he indicated that he only considered that part of the record of the PRHA case that was submitted in the instant case. When questioned about his

hallway conversation with Engineer Da Silva, the Special Master testified that the conversation was inconsequential and unrelated to this case. He was then questioned on the nature and source of Exhibit VIII to which he replied that it was a summary derived from the daily activity reports submitted by Explo during the hearings as Exhibit J. No further questions were asked of Mr. Barros and Garlam did not present any other witness or evidence in support of its position. It is necessary to consider the legal criteria which are relevant to a determination of the validity of these objections.

The applicable standard of review upon evaluating the Special Master's conclusions requires that the findings be given great weight and not disregarded unless clearly erroneous. De Costa

v. Columbia Broadcasting Systems, Inc., 520 F.2d 499, 508 (1st Cir. 1975); United States v. S. Volpe and Co., 359 F.2d 132, 134 (1st Cir. 1966); see Masters and Magistrates in the Federal Courts, 88 Harv. L. Rev. 779, 789-96 (1975).8/ Although the master may disregard evi-

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8/ We consider Garlam's "due process" claim as another form of voicing its objections to the Special Master under the "clearly erroneous" rule because Garlam has not presented to us authorities in support of the constitutional aspects of its argument and its particular factual basis. This lack of elaboration makes the configuration of the 'due process' claim difficult, if not impossible to perceive, and, without dwelling too deeply on this point, the merits of the claim appear also of dubious value considering that the Special Master's findings are mere recommendations that cannot be enforced without the Court's approval. See D.M.W. Contracting Co. v. Stolz, 158 F.2d 405 (D.C. Cir. 1946); In re Mifflin Chem. Corp., 123 F.2d 311 (3rd Cir. 1941). In any event, indicate any serious impropriety on the Master's conduction of the proceedings, whatever due process claim that can be sketched from Garlam's allegations also fails to materialize from the Master's conduct.

dence he considers of his own without following ordinary judicial procedures. Baker v. Simmons Company, 325 F.2d 580, 583 (1st Cir. 1963). However, use of reference books to aid a master in the technical aspects of the evaluation is permitted. See id. at 583, n. 3. The objections to a master's findings must be specific, United States v. Merz, 376 U.S. 192, 199 (1964); AFL-CIO v. NLRB, 547 F.2d 575 (4th Cir. 1976) cert. denied 431 U.S. 966; Badger By-Products Co. v. Employers Mut. Cas. Co., 65 F.R.D. 4 (E.D. Wis. 1974) aff'd. 519 F.2d 1406 (7th Cir. 1975), and the party challenging the findings carries the burden of demonstrating the existence of "clear error." NLRB v. Crockett Bradley, Inc., 598 F.2d 971 (5th Cir. 1979).

In the present situation, we conclude that Garlam failed to carry its burden of

proving that Special Master Ulises Barros relied on evidence not on record to support his findings. Each one of the exhibits accompanying Explo's memorandum of law contained information that had been offered at the hearings and the findings of the Master do not rest solely on these exhibits. In fact, even under the stricter standard of review of mixed questions of law and fact, see: Da Coste, ante, we find that they are merely supplementary and illustrative of information already existing in the record.

At the hearing, Garlam limited its showing of the Special Master's error to questioning him on only some of the allegations of improper behavior. Yet, even these failed to indicate that he acted erroneously. For example, although Garlam spent the greater part of the

hearing questioning the Special Master about his reliance on the daily activity reports, it could not controvert the fact that these reports had been submitted as evidence and that Exhibit VIII was only a summary of some of them. Garlam also failed to pinpoint what specific material from the PRHA case that was not presented as evidence before the Special Master was used by him to support a certain finding. Specificity on this matter was necessary since many documents from the PRHA case were in fact presented as evidence during the hearing. The Special Master's statements under oath in response to the court's questions also remained uncontradicted by Garlam and a review of the record reveals that they contain information found in evidence that had been previously submitted, particularly in Exhibits A, 10, 10A, G, 13, 31, 30, J,

JI, and B and in the testimony of the witnesses at the hearing. After the hearing the accusation that the Special Master conversed with the witness on matters related to the case was left unfounded and remained only as a hasty comment by an overzealous lawyer who in pursuit of his client's interest apparently lost sight of the damaging side effects of such type of imputations.9/ Since the "due process" claim has not been substantiated by Garlam, the request to set aside the Master's Report on that ground is DENIED.

As to the objections to the report, we first confront Explo's basic quarrel

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9/ We also note the belatedness of this objection. Although counsel for Garlam stated that he saw the Special Master talking in the hallway with Engineer Da Silva, he did not inform the Court or the Master of his concern or objection until after the Report had been filed.

with the Master's findings on the necessary burden of proof of damages on the item of rock blasted. It contends that Garlam failed to carry this burden by not making the cross-section measurements of the blasted rock in the field, as required by the contract, which was the only reliable way of ascertaining the measure of damages. It does not contend that the Master's method of determining these quantities was erroneous, but rather, that the lack of cross-section measurement was a failure by Garlam of meeting its burden and that dismissal was mandated. The Master, although recognizing the difficulty in arriving at precise figures due to the lack of adequate information on the record, did rely on other methods to arrive at the conclusions. He also found that the party responsible for the breach (Explo) should

not benefit from any difficulty in computing damages. Although we recognize that the Special Master was not designated to make such a finding, we believe it is not necessary to determine whether the principle of law referred to was correctly applied[10/] because his findings on this matter are not mere conjecture. These findings are supported by the preponderance of evidence on record and are the result of mathematical computations that give the most precise approximations possible under the circumstances. This analysis is derived from facts established by the evidence before him and under the "clearly erroneous" standard of review Explo must demonstrate that there is absolutely no rational support in the

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10/ See: Trans World Airlines, Inc. v. Hughes, 449 F.2d 51, 72-3 (2nd Cir. 1974).

record for the Master's conclusions. See: Western Geophysical Co. v. Bolt Associates, Inc., 584 F.2d 1164, 1174 (2nd Cir. 1978). Otherwise, it would practically require that the reviewing court make a de novo determination of the factual issues to determine which should be given more weight. See: Zenith Radio Corp. v. Hazeltine Research. Inc., 395 U.S. 100, 123 (1969); Matley v. United Shoe Mach Corp., 54 F. Supp. 694 (D. Mass. 1944). Explo must show that it is clearly erroneous to conclude that the weight of the evidence is sufficient to support the Master's conclusions and determinations. Cf: United States v. 79.95 Acres of Land, 459 F.2d 185, 187 (10th Cir. 1972) (award duly appointed commission in expropriation proceeding may be adopted by trial court unless contrary to clear weight of the evidence).

We believe no such error has been shown. The important consideration is that the finding was supported by sufficient evidence in the record so as to enable the Master to arrive at the most precise estimates possible. Explo has not shown how clear error was committed by using other available data to make these calculations; see: Arrow Distilleries v. Arrow Distilleries, 117 F.2d 636, 638-639 (7th Cir. 1941), nor has it indicated that the only possible way to arrive at this finding would have been by the use of cross-section measurement. Its contention that the Master should not have awarded any damages because Garlam did not comply with the contractual provision of the cross-section measurement would have required a finding of contractual liability and not an assessment of damages. This limitation would have also

entailed the imposition of a higher burden of proof on Garlam; see: NLRB v. Blevins Popcorn Co., 659 F.2d 1173, 1186 (D.C. Cir. 1981). This was clearly not the Master's function.

Garlam's numerous objections to the Report can be classified as falling in either one of these categories: the technical basis used is incorrect; the Master did not consider certain evidence on record; the Master went beyond the limits of his assigned duties (i.e. the order of reference and Judge Bootle's opinion), and the Master accepted inadmissible evidence. Garlam, however, has not cited authorities that would support its proposition that the Master cannot rely on some of the evidence and disregard other. In fact, the cases seem to point to the opposite direction, specially when the evidence is presented

through conflicting live testimony and matters of credibility are involved; see: Tilghman v. Proctor, 125 U.S. 136, 149-150 (1888); Costello v. Fazio, 256 F.2d 903 (9th Cir. 1958); O'Hara v. Murphy, 137 F.2d 154 (1st Cir. 1943) cert. denied. We find that there was no "clear error" in the Special Master's conclusions or in his decision to rely more strongly on some evidence than on other. His reliance on certain technical information and not on the one to the liking of Garlam is not a clearly erroneous conduct. lt is merely a matter of deciding which of the conflicting experts is the most reliable. This, by itself, is nothing more than part of the balancing process the Special Master had to do, and, unless his decision to rely on certain expert or technical information is shown to be clearly erroneous, this

court, in its reviewing function, must accept it as correct. Otherwise, there would be no purpose in appointing a special master. In this particular case, where Special Master Barros was appointed because the parties wanted someone with the adequate expertise to deal with the difficult technical and accounting questions that the determination entailed,11/ Garlam must come forward with something more than its allegations of what were the proper engineering standards and definitions that the Master should have considered. The Special Master did not have to rely on certain evidence, a certain expert or on a certain treatise, unless it is shown that by not doing so his findings were clearly erroneous. This has not been shown and there is no

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11/ See Order of Reference, September 12, 1979.

reason to reject the findings of the Special Master because he relied on the technical evidence which he determined was most appropriate and trustworthy.

The parameters of the Special Master's findings are found in the Order of Reference. This order, in turn, referred the Special Master to the findings contained in Judge Bootle's opinion. Garlam contends that the Special Master ignored the findings of liability made by Judge Bootle, while Explo contends that, contrary to the Opinion, the Master's detailed findings reveal that the amount owed to Explo was not insubstantial and, therefore, justified its abandonment of the project. Explo contends that, in view of the information revealed by the Master's Report, the Opinion cannot stand. Both parties are relying on erro-

neous interpretations of Judge Bootle's Opinion.

In the first place, Explo's reliance on isolated parts of the Opinion to justify its perception of the holding detracts from its proper understanding, something which can only be attained by examining the opinion in its entirety. This partial examination of the liability decision overlooks the fact that Explo did not render a satisfactory performance during the few months of its involvement in the project. Its liability, therefore, was not premised solely on the act of abandoning the project but it also comprised its inadequate performance. This inadequate performance is revealed by the Master's finding of the small amount of rock blasted and ripped by Explo in four months of operations and in finding that Explo was liable for some of

the extra cost. Such faulty performance, coupled with its mid-project abandonment, resulted in the adverse finding of liability against plaintiff. It is also important to recognize as did Judge Bootle, that this contract involved an interplay of many entities and factors, each depending on the other for the fulfillment of their obligations. The payment provisions were in no way a simple buy-sell transaction whereby the simultaneous performances would clearly manifest the certainty of each reciprocal obligation. The payment to Explo depended on the PRHA's certification and payment to Garlam and these payment provisions also required that the work performed comply with many technical requirements before payment was certified. Judge Bootle's estimate of the amount owed was not far from the mark

since $40,000.00 is in effect a very insignificant sum compared to the original stipulated price for the complete work ($1,200,000.00). In short, Judge Bootle found that in view of the payment provisions of the contract with PRHA, the deficient work performed by Explo, the amounts owed to Garlam at the time of abandonment on November 3, 1971, and the original extension of the contract, Explo's abandonment of the project, leaving unfinished the major part of its work, was unjustified. He thus concluded "that the real reason for the abandonment of the project by Explo was not any breach or failure of performance on the part of Garlam but was Explo's decision to abandon what for it was proving to be an unprofitable contract." Opinion at p. 19. The exact amount owed to Explo was not indispensable to make such a finding,

for the Court, working with the estimates available at that time, could devise a reliable way to balance both parties' contractual performance and decide whether the conduct of each in light of the other party's action, was justified or not. Although as Explo contends, the Courts in Puerto Rico have recognized that the implied resolutory condition of a bilateral obligation under Article 1077 of the Civil Code, P.R. Laws Ann., Tit. 31 Sec. 3052,12/ can be exercised without recourse to the courts, see: Federal Land Bank v. Echeandia, 48 PRR 311 (1935) it is also true that when the exeptio non adimpleti contractus justification is questioned the courts must then

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12/ Article 1077 in its pertinent part states: "The right to rescind the obligations is considered as implied in mutual ones, in case one of the obligated persons does not comply with what is incumbent upon him."

determine if it has been applied in the proper context and in consonance with its requirements. See generally on the requirements of this exception: Guaroa Velazques, Las Obligaciones Segun el Derecho Puertorriqueno, pp. 75-81 (1968 Ed.); 1 E. Vazquez Bote, Derecho Civil de Puerto Rico, Tomo III, pp. 140-144 (1973 Ed.); II, J. Puig Brutau, Fundamentos de Derecho Civil, Derecho General de las Obligaciones, Tomo I, pp. 152-164 (1959 Ed.). The Supreme Court of Puerto Rico in Velez v. Rios, 76 PRR 806 (1954), cited Spanish civil law commentator Manresa on Spain's equivalent article who states that: " '[T]he action for resolution of contract requires an actual and adequate breach which generally is not equivalent to a mere delay in payment . . . .' " Id. at 812. And the Supreme Court of Spain, when interpreting this

article, has indicated that not all forms of nonperformance or breach bring the exception into play. The breach must be definite and complete. See: Judgment of July 8, 1959, Tribunal Supremo Espanol. The exception contained in the Article should not be interpreted to apply automatically to any minor infringement but requires rather a rational and logical application to the circumstances to determine if these called for resolution. See: Judgment of January 5, 1953, Tribunal Supremo Espanol. This was precisely what Judge Bootle determined. Upon analyzing the contractual terms and the circumstances of this particular case, he found that Explo's abandonment was not justified by the alleged nonpayment and that it was not entitled to benefit from the provisions of Article 1077. We see no reason to disturb such a finding since

it is not only supported by the general principles of civil law discussed but does not contradict the Master's essential findings.13/

There are also no equitable reasons to set aside the Opinion and begin anew this ten year old case simply because Judge Bootle had the foresight of indicating that Explo would be credited with whatever amount Garlam owed to it for the blasting performed until abandonment. In this manner, Garlam was not left unaccountable for its nonpayment.

13/ Explo argues that Judge Bootle's opinion and judgment on the issue of liability is a provisional order that may be modified by the court and cites Haverhill Gazette Company v. Union Leader Corporation, 333 F.2d 798 (1st Cir. 1964). Since we have determined that the Report can be reconciled with the Opinion, the special circumstances of Haverhill, id. at 803, are not present in this case.

There are, however, reasons which move us to modify the court's previous ruling imposing the totality of the Special Master's fees and expenses on Explo.[14] Explo has requested modification of this order alleging that the reduction of Garlam's damages by almost three million dollars demonstrates that Garlam exaggerated its damages, thus justifying Explo's challenge to these sums and the resulting litigation on that issue. Garlam contends that Explo was obstinate because it consciously delayed the proceedings to its advantage. We would rather not pin the blame for the delay in this case on the failure of Congress to recognize the needs of liti-

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[14] These amount to $55,457.30 (969 hours at $55 per hour); see Motion-Statement of Costs and Expenses filed by the Special Master on June 11, 1980. The amount has not been contested by any of the parties.

gants, as Explo so aptly phrased it, for the reasons that turned this case into a ten year almost endless collection of legal and technical data are not found in a single cause. This delay was brought about by a complicated set of factors, that included not only the problems of modern judicial administration but also the parties' litigation strategy and the technical nature of the matters in controversy. The new light cast by the Master's findings on the real damages suffered convinces us that Explo was not obstinate in its defense of the case. The amount owed was certainly contested and was so indefinite that its determination required the appointment of a special master. There are reasons that can be ascribed to both parties' conduct which also account for the delay. Other circumstances, besides Explo's breach,

contributed to the difficulty in ascertaining the issues. For example, we believe the Master's task could have perhaps been made easier if Garlam had conducted the cross-section field measurements. Both parties, being in many ways equally responsible for the difficulties encountered in this case and the claims being immersed in such complexity and uncertainty, we consider that fairness dictates that the costs incurred by Special Master Ulises Barros be borne by both in equal proportion. Thus, in view of the new information provided by the Report and considering the discretion granted to the Court on this matter, see: Rule 53(a) Fed. R. Civ. P.; Morgan v. Kerrigan, 530 F.2d 401, 427 (1st Cir. 1976); Marks v. Polaroid Corp., 237 F. Supp. 425-426 (D. Mass. 1964); E.I. Du Pont de Nemours & Co. v. Purofied Down,

Etc., 176 F. Supp. 688, 701 (S.D.N.Y. 1959), we now ORDER that the costs of the Special Master be paid by Explo and Garlam in equal proportion. For these same reasons,15/ we conclude that Explo has not conducted the litigation in an obstinate manner and that imposition of prejudgment interest, cost and attorney's fees is not justified. Accordingly, Garlam's request that prejudgment interest, cost and attorney's fees be awarded to it from September 30, 1976 at 1.5 points over the New York Prime Rate if DENIED.

15/ The Master's findings prove that Explo's claim was not frivolous unless one can consider the defense of almost three million dollars of liability as obstinate litigation. The damages were certainly not uncontested and there was no indication of any misuse of legal procedures to delay the case. See: Ferrer Delgado v. Sylvia de Jesus, 440 F. Supp. 979, 982 (DPR 1976).

Garlam's contention that the Special Master went beyond the bounds of the Order of Reference is also founded upon improper and out of context interpretations of the Opinion. Garlam is under the mistaken impression that the fixing of liability upon Explo entailed imposing on this party whatever other extra costs that Garlam incurred in completing the project. This ignores the Master's finding that there were other reasons, unrelated to Explo's breach, which resulted in additional and unanticipated expenses. The difficult task of separating which extra costs were related to Explo's breach was meticulously performed by the Special Master in consonance with the Opinion and the Order of Reference. For instance, Garlam objects to his finding that the equipment bought by it are not damages resulting from Explo's

breach for this equipment was not acquired to remedy Explo's misperformance but rather so that Garlam could speed up the project and benefit from the bonus provisions for early termination in the contract with PRHA. Garlam argues that Judge Bootle had already determined this matter in its favor. There is, however, no such determination in the Opinion. At page 7 of the Opinion on liability it is said: "Some questions have been raised by Explo as to the sufficiency and propriety of the equipment of Garlam but the evidence fails to show the truth of the allegations or the relevancy of the allegations concerning the issues before the court in this first trial." This matter dealt with Explo's allegations that it abandoned the project because Garlam did not provide proper equipment. The court did not consider the allegations con-

cerning the investment in new equipment as relevant to that part of the case. These were left for the Master's determination in the second stage of the case, as they were in fact determined.16/ Nothing in the court's decision on liability indicates that the cost of this item was to be attributed to Explo.

Finally, Garlam makes a general reference to the use of depositions in support of the Special Master's findings and urges that the report be rejected because it disregarded Rule 32, Fed. R. Civ. P. does not object to the admissibility of the depositions under Rule

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16/ Contrary to Explo's contention the Master did not determine that Explo did not have proper equipment and that for this reason it abandoned the project. Judge Bootle's finding on this matter was left untouched for the Master's findings were to determine if the new equipment was bought by Garlam as a result of Explo's breach.

32(b) or to their use in substitution of live testimony pursuant to Rule 32(a)(3). Nor has it requested that other parts of a deposition offered only partially be introduced.

In its customary diffuse manner of argumentation, Garlam requests that we reject the report and appoint a new master because it found mathematical errors in the report. It claims that the report is "plagued" with such type of errors yet mentions only one. The others, raised in its objections to the preliminary report, were corrected by the master as clerical errors and the remaining one, the result of Garlam's own submitted data, had no significant effect on the overall computations. Although some of these errors are clearly apparent from the record, their impact on the findings has not been shown by Garlam. Garlam has not shown

what precise findings must be rejected as tainted because the Master relied solely on the mathematical mistake or on inadmissible depositions. In the case of the depositions, the lack of specificity makes Garlam's undefined objection even weaker for there were many depositions considered by the master which were admissible under Rule 32 Fed. R. Civ. P.; for example, those of corporation officers, government agency representatives, or simply for impeachment purposes, some of which were filed by Garlam itself. There are no findings in the report based solely on a deposition for its support. There are no indications, by Garlam or otherwise, of irregularities in the taking of the depositions or of grounds which would make them inadmissible.

In sum, neither Garlam nor Explo have demonstrated clearly erroneous findings

which would require that we reject the Master's conclusions. We are aware that the report is not without imperfection. The flaws, however, are not substantial. They are a speck in the immense task of compiling and analyzing the technical data involved in this case and making findings which are supported by the evidence and by rational and reasonable inferences derived therefrom; see: Socony-Vacuum Oil Co. v. Oil City Refiners, 136 F.2d 470, 473 (6th Cir. 1943) cert. denied 320 US 798. Perhaps the issues of liability and damages in this case were so intertwined that the decision to sever was not the one most indicated. See: Haverhill Gazette Co. v. Union Leader Corp., 333 F.2d 798, 804, n. 10 (1st Cir. 1964). Yet only from the comfortable security that hindsight provides can we arrive at this conclusion.

At the moment the decision was made, the parties acquiesced and believed that this was the proper path to tread. They also accepted the appointment of a special master without any objections whatsoever. Garlam's insinuation that they were somehow forced into it is frivolous. At this stage in the proceedings, the validity of the appointment and qualifications of the master never having been questioned before, our task in examining his report is limited to examining the record for clear error. Such "clear errors" have not been shown and an exhaustive examination of the entire record has failed to reveal any. The findings of the Special Master are, therefore, adopted as the findings of this Court on the issue of damages.

SO ORDERED

At San Juan, Puerto Rico, on November 16, 1982.

CARMEN CONSUELO CEREZO
United States District Judge

72518

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF PUERTO RICO

EXPLOSIVES CORPORATION OF AMERICA,	)	
Plaintiff	)	
vs	)	CIVIL 72-0001CC
GARLAM ENTERPRISES CORPORATION & FEDERAL INSURANCE COMPANY	)	
Defendants	)	

JUDGMENT

Having considered the decision of Judge Bootle on the issue of liability entered on April 4, 1976 and our opinion and order of November 10, 1982 adopting the findings of the Special Master on the issue of damages, Judgment is hereby entered in favor of defendant counter-claimant, Garlam Enterprises Corporation and against plaintiff Explosives Corporation of America and its surety

General Insurance of America[1/] in the total sum of $2,423,177.00. The motions for pre-judgment interest, costs and attorney's fees filed by Garlam Enterprises Corporation are DENIED.

The Special Master's fees which amount to $55,457.80 shall be paid by Explosives Corporation of America and by Garlam Enterprise Corporation in equal proportions.

SO ORDERED AND ADJUDGED.

At San Juan, Puerto Rico, on November 16, 1982.

CARMEN CONSUELO CEREZO
United States District Judge

72736

1/The liability of General Insurance of America is limited to the sum of $1,230,000.00 fixed in the payment and performance bond.

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF PUERTO RICO

EXPLOSIVES CORPORATION OF AMERICA,	)	
Plaintiff	)	CIVIL 72-0001CC
vs	)	
GARLAM ENTERPRISES CORPORATION & FEDERAL INSURANCE COMPANY	)	
Defendants	)	

MEMORANDUM OPINION AND ORDER

On September 9, 1977 Garlam Enterprises Corporation, defendant and counterclaimant, filed a motion requesting substitution of parties under Rule 25(c), Fed. R. Civ. P. on the grounds that Explo had been dissolved in 1975 by merger with Excoa, Inc. which, in turn, was "liquidated or dissolved" into Rocket Research Corporation, now called Rockor, Inc. (Rocket). Movant stated

that Excoa and Explo were both wholly-owned by Rocket and that the latter was now paying the attorneys' fees for Explo in this case. Plaintiff opposed this contending that to bring Rocket at such a late stage of the proceeding and to hold it liable before having had its day in court would violate the due process clause of the Constitution. It also argued that Rocket had not been served in accordance with the requirements of Rule 25[1/] and cited Ransom v Brennan, 437 F.2d

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1/ Rule 25 Fed. R. Civ. P. in its pertinent part states:

(a) Death

(1) . . . The motion for substitution . . . together with the notice of hearing shall be served on the parties as provided in Rule 5 and upon persons not parties in the manner provided in Rule 4 for the service of summons and may be served in any judicial district. . . .

(See next page.)

513 (5th Cir. 1971) cert. denied 403 US 904, in support of the proposition that a Rule 5, Fed. R. Civ. P. service was not sufficient to invest the Court with personal jurisdiction over a substituted party. The request for substitution of parties was subsequently withdrawn and a petition to amend the counterclaim[2/] to join Rocket as a party liable to Garlam was granted. Rocket then filed a Motion to Dismiss for lack of personal jurisdic-

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(2) . . . .

(b) . . . .

(c) Transfer of interest. . . . Service of the motion shall be made as provided in subdivision (a) of this Rule. . . .

2/ Although referred to as a third-party complaint, the pleadings reveal that Garlam's amended complaint is in reality an amended counterclaim joining Rocket as counterdefendant with Explo, Excoa and General Insurance Company of America; see: R. 13(h) Fed. R. Civ. P.

tion alleging that since it had no contacts with this forum prior to acquiring Explo's interest in this action, the order permitting its joinder as a party liable to Garlam constitutes a violation of the due process principles outlined in International Shoe Co. v Washington, 326 US 310 (1945), particularly since Explo, its predecessor, had already been found liable to Garlam. See: Partial Judgment issued on April 4, 1976. It urges that this would be tantamount to a determination on the merits that it was the alter ego or corporate shell of Explo and, thus, responsible for the latter's liabilities. Finally, it is suggested that Rocket was not properly served and that, assuming arguendo that Garlam's allegations are true, dismissal of the amended counterclaim is warranted under the doctrine of forum non

conveniens. The affidavit of Dr. George S. Sutherland, movant's Chairman of the Board and Chief Executive Officer, filed in support of dismissal states that in 1973 Explo was merged into Excoa which was dissolved in 1976 and that it conveyed its assets to Rocket[3/] in partial satisfaction of its debts.

3/ In 1973, Excoa, Inc. was formed as a Washington Corporation for the purpose of developing and manufacturing explosives and all forms of chemicals. Shortly thereafter, Explo was merged into Excoa, Inc. The merger was undertaken by a short form merger procedure through which the sole shareholder of Excoa, Inc., bought out the interests of Explo shareholders. Since there was no public market for the stock, the offering price was based upon a valuation made by an independent consultant. From 1973 to until the time of its dissolution, Excoa, Inc. was maintained distinct from Rocket, with the business of the two companies continuing to be separate; Rocket continued in the rocket engine and propellant business and Excoa attempted to remain in the explosives business. At the time of Excoa's dissolution in 1976, Excoa owed

(See next page.)

Rocket's Motion to Dismiss was initially denied but, upon reconsideration, it was decided that there was no personal jurisdiction over it and the action against it was dismissed. In its revised ruling the court emphasized that most of the alleged contacts with the forum were not supported by the record and that others were irrelevant--for example, that Rocket was paying the attorney's fees for Explo's defense in this action--since they occurred in 1976 after Rocket had acquired the cause of action and not when the suit was instituted. Dragor Shipping

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(Continued from previous page.)

Rocket several millions of dollars as a result of its losing operations. As partial satisfaction of those debts, Excoa conveyed its assets in partial satisfaction of such obligations. However, due to the financial condition of Excoa, no distribution of assets could be made to Rocket as a shareholder of Excoa. (Affidavit of George Sutherland pp. 3 and 4.)

Corp. v Union Tank Car Co., 361 F.2d 43 (7th Cir. 1966) cert. denied Union Tank Car Co. v Dragor Shipping Corp., 385 US 831, was cited in support of the proposition that personal jurisdiction over a party must exist at the time the complaint is filed and cannot be acquired by later contacts with the forum. Thereafter, Garlam filed a motion for reconsideration which was opposed by Rocket. However, the court by footnote order of December 28, 1979, determined that the motion for reconsideration was moot since Garlam had already appealed the dismissal order.4/ On May 27, 1981 Garlam requested that the motion for reconsideration be reinstated. The mat-

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4/ The appeal was dismissed for lack of appellate jurisdiction on December 10, 1979. Garlam contends that this footnote order was never notified and there is no indication in the record that it was.

ter concerning the request to reconsider was referred to Chief Judge Pesquera who subsequently disqualified himself. The parties then filed other motions requesting reinstatement of the motion, on the one hand, and dismissal as moot and untimely, on the other.

If we consider the procedural framework against which the court was determining the issue of personal jurisdiction, the findings and legal standards contained in its order are correct. By focusing the matter as a request to amend the counterclaim to add a new party responsible to Garlam on the merits of a prior determination of contractual liability in its favor, the conclusion that there was no personal jurisdiction over Rocket was correct. If one considers the possible retroactive effect of the amended counterclaim, the lack of any

indication as to Rocket's involvement with this forum prior to the transfer of assets, and the fact that liability had already been determined, the court, if it was to reconcile its ruling with the due process considerations of International Shoe and its progeny (see: World-Wide Volkswagen Corp. v Woodson, 444 US 286 (1980), had no alternative but to dismiss. As Rocket correctly contends, to have ruled otherwise would have entailed a determination without any type of hearing that Rocket was Explo's alter ego all throughout. Viewed within the procedural backdrop of Garlam's request, the determination that there was no personal jurisdiction over Rocket so as to join it as a party according to the criteria of Rules 13(h), 15, 17 and 19, Federal Rules of Civil Procedure, that is, directly liable to Garlam on the action for breach

of contract for the reasons already determined by Judge Bootle, the order of October 29, 1979 is entirely correct and reconsideration is unwarranted. If the issues, however, had been defined within the context of a Rule 25(c) substitution[5/] the ensuing consequences as well as the court's determination, would have been different.

In considering the propriety of a Rule 25(c) substitution it is of paramount importance to recognize that the substitution or joinder does not affect the substantive rights of the transfer[or] or of the transferee.

5/ Garlam contends that it abandoned its request for substitution at the request of Judge Pesquera. There is nothing in the record to sustain this. We must assume that these decisions are voluntarily made and that counsel understand the consequences of the procedural strategy they wish to follow.

Television Reception Corporation v Dunbar, 426 F.2d 174, 178 (6th Cir. 1970): Federal Deposit Ins. Corp. v Tisch, 89 FRD 446, 448 (EDNY 1981). This consideration is essential in order to understand that the possible substitution of Rocket as Explo's transferee is not a determination of Rocket's liability. In the first place, as both Explo and Rocket have suggested, it would be hasty to arrive at this conclusion at a moment when we do not know if Explo will not satisfy the judgment. Of yet greater importance are the possible violations to the due process clause that such a determination would entail if made without an adequate hearing. Likewise, it is necessary to realize that the answers to the question of Rocket's liability are not found in the court's decision concerning

Explo's contractual liability to Garlam, but rather, are best approached by examining the applicable criteria to determine in what situation a transfer of corporate assets also includes the transfer of the corporation's liabilities.6/ This is so for Rocket was brought to this action as a possible successor in interest of Explo which would be liable to Garlam on the basis of the judgment and not on the basis of the contractual rela-

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6/ Without advancing the applicable law to the present circumstances we note that the general view is that when one corporation sells or otherwise transfers all of its assets to another corporation the latter is not liable for the debts and liabilities of the transferor, except if the purchaser expressly or impliedly agreed to assume such debts, if the transaction amounts to a consolidation or merger of the corporations, if the purchasing corporation is merely a continuation of the selling corporation or if the transaction is entered into fraudulently to avoid liability. R.J. Enstrom Corp. v Interceptor Corp., 555 F.2d 277, 281-2 (10th Cir. 1977).

tionship liability that originated the case.

In Panther Pumps & Equipment Co. v Hydrocraft, Inc., 566 F.2d 8 (7th Cir. 1977) cert. denied Beck v Morrison Pump Co., 435 US 1013 (Panther Pumps), the district court accepted the argument raised by a party brought under Rule 25(c) that to join it would violate the due process clause since judgment had already been entered. The appellate court reversed stating that the lower court had misconceived the charge against the party to be substituted and the reasons for bringing him to the action at that stage, stating:7/

> Beck, in the motion to substitute, was not charged with 'the original patent infringement.'

7/ Opinion by Howard Thomas Markey, Chief Judge of the United States Court of Customs and Patent Appeals, sitting by designation.

> Beck was charged with acts by which he became the successor in interest of Hydrocraft, a judgment debtor. The nature of the original tort that resulted in the judgment is immaterial. It could have been libel, slander, assault, battery, patent infringement or some other tort. The charge was (and is) that Beck is the successor in interest of the judgment and debtor and therefore liable on the judgment. Against this charge Beck was entitled under the Due Process Clause to an opportunity to defend himself. Id. at 24.

The Court then determined that Beck had that opportunity at the hearing where the charge that he was defendant's successor in interest was fully discussed. The question of personal jurisdiction in this case, viewed in its proper perspective, is not one of determining whether personal jurisdiction over the party to be substituted existed since the filing of the complaint but rather whether the reasons adduced for a Rule 25 substitution

are sufficient to persuade the court[8] that at this stage of the proceedings there is cause to issue an order to bring into the action the party to be substituted[9] and then to determine if

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8/ On the matter of the exercise of discretion in granting a Rule 25 substitution see: Prop-Jets, Inc. v Chandler, 575 F.2d 1322, 1324 (10th Cir. 1978) and Froning's Inc. v Johnston Feed Serv., Inc., 568 F.2d 108, 110 n.4 (8th Cir. 1978); cf. United States v F.D. Rich Company, 437 F.2d 549 (9th Cir. 1970) (ample discretion to substitute parties where a corporate dissolution or some other act affecting the capacity to sue has occurred).

9/ In a similar fashion, a court may accept as a legal fiction subject to later challenge that specific allegations of a complaint as to an out of state parent corporation officer's negligent acts are sufficient to determine at an early stage in the proceeding that personal jurisdiction exists and that the Court has authority to summon that party, see: Escude Cruz v Ortho Pharmaceutical Corp. 619 F.2d 902 (1st Cir. 1980). It has also been recognized as an inherent attribute of a court that it has the power or authority to determine jurisdiction. See generally: 13, C. Wright, A. Miller and E. Cooper, Federal Practice and Procedure, Sec. 3566 (1975 ed.).

substitution is proper. The crucial period then to determine as to when personal jurisdiction over the substituted party must exist is at the moment when substitution is requested.

The two cases that Rocket has brought to our attention which discuss issues related to the present situation do not support the proposition that personal jurisdiction must exist over the party to be substituted since the filing of the complaint. In Panther Pumps, the court denied the motion for substitution of a corporation (Universal) that had received the assets of defendant corporation Hydrocraft because it faced the "insurmountable obstacle" of lack of personal jurisdiction. Id. at 23. However, this holding, when examined in its particular factual situation, does not necessarily govern our decision today. In

that case the court did impose liability of the judgment-debtor upon a successor[10] thus, allowing plaintiff to obtain an effective judgment, whereas in our situation there is a real possibility that Explo's assets may be insufficient to cover part of Garlam's judgment and that there would be no other entity or person from whom recovery can be had. Panther Pumps merely states that the district court had not acquired jurisdiction. The reasons why the trial court did not exercise personal jurisdiction over Universal,[11] while doing so as

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10/ Mr. Louis Beck (Beck) whom the Court found to be Hydrocraft's successor in interest.

11/ The court said at page 23:

> The motion to substitute Universal faces an insurmountable obstacle: lack of personal jurisdiction. 'The consistent constitutional rule has been that a

(See next page.)

to Beck, were not discussed nor was any explanation given as to why there was no personal jurisdiction over the corporation. All that was said was that the lower court's order was only directed to Beck and did not include Universal. The lack of elaboration in Panther Pumps on this particular matter serves to provide little, if no guidance.

. In any event, it should be noted that the district court's decision on the matter of substituting parties under Rule

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court has no power to adjudicate a personal claim or obligation unless it had jurisdiction over the person of the defendant.' Zenith Radio Corp. v Hazeltime Research, Inc., 395 US 100, [sic] 110, 89 S.Ct. 1562, 1569, 23 L.Ed. 2d 129 (1969). The district court's order to show cause was directed only to Beck, it did not bring Universal before the lower court. Although we have held, supra, that Universal is merely Beck's alter ego, that fact cannot alone confer personal jurisdiction over Universal.

25(c) was taken after a two week evidentiary hearing. Id. at 24. In contrast to our case, an opportunity was given to fully discuss the arguments and to present evidence in support of the need to substitute. Also significant is the fact that, although the Circuit Court felt that it was unnecessary to rule on the lower court's determination of personal jurisdiction over Beck,12/ the facts of that case reveal that Beck was not an original defendant and that the court acquired personal jurisdiction over him because of acts he committed after the complaint was filed. The other case relied upon by Rocket, Ransom v Brennam,

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12/ "Respecting Beck, however, the lower court held that it had personal jurisdiction over Beck and he has not appealed that ruling. It is res judicata that the order to show cause was properly issued by the district court and that it subjected Beck to the district court's jurisdiction. . . ." Id.

437 F.2d 513 (5th Cir. 1971), cert. denied 403 US 904 (Ransom), serves only to further strengthen the position that personal jurisdiction over a substituted party does not necessarily have to exist from the moment the complaint is filed. In Ransom, after the defendant died plaintiffs moved to substitute the decedent's executrix pursuant to Rule 25(a)(1). The executrix was notified according to Rule 5, Fed. R. Civ. P., by mailing the motion to decedent's attorney. The court found the notice improper and dismissed the motion for substitution. The question was posed as to what a court "having subject matter jurisdiction must do to obtain personal jurisdiction over the party sought to be substituted. . . ." Id. at 516. It was held that, in order for the court to acquire personal jurisdiction, Rule 4,

Fed. R. Civ. P., had to be used when the party to be substituted had not previously appeared in the action. Discussing the trial court's reliance on the holding of Butsch v Canterbury, 18 FRD 23 (SDCal. 1955), to the effect that once personal jurisdiction was acquired over the original party it continued over the substituted party, the Circuit Court commented:

> If this second clause is construed otherwise, as a statement that in personam jurisdiction over the original party so continues over the party named as a potential substitute as to subject him to the power of the court without the necessity of service of process, then in our opinion it is wrong, and we decline to adopt any such principle. Ransom at 518.

Thus, Ransom stands for the proposition that if the substituted party has never before appeared he must be served pursuant to Rule 4, Fed. R. Civ. P. To infer

from this holding what Rocket pretends is a misinterpretation. On the contrary, the court in Ransom suggested that it could acquire personal jurisdiction over the executrix by the proper service of summons even though she had no relationship or contacts with the forum. It interpreted the wording in Rule 25(a)(1) permitting service of the motion and notice of hearing "in any judicial district" and Rule 4(f) Fed. R. Civ. P., which provides that service of process may be made beyond the territorial limits of the state in which the district court is held when authorized by the rules, to support its authority to serve summons outside its territorial limits. However, since the executrix had not been summoned properly the motion for substitution was denied. In any event, Rocket's involvement with our forum upon acquiring an

interest in an ongoing judicial proceeding and the fact that it is paying for Explo's attorney's fees in this action,13/ coupled with the real possibility that a party could be deprived of its right to obtain an effective judgment, are more than sufficient, even assuming the dubious minimum contacts requirement, to determine if substitution should be made and to consider if Rocket is liable as a successor in interest. See: American Renaissance Lines, Inc. v Saxis Steamship Co., 71 FRD 703, 705 EDNY 1976); Wainwright v Kraftco Corporation, 58 FRD 9, 13 (NDGa. 1973). Rocket's voluntary decision to acquire Explo's

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13/ Although the Court mentioned in its order of October 29, 1979 that this fact was not adequately proven, counsel for Explo, later admitted by sworn statement that Rocket had been paying the attorney's fees incurred in this action since it acquired the interest.

interests in this litigation and to monitor its course by paying the attorneys afforded it sufficient actual notice of the exact nature and complexities of the case and of the probable risks in order to prepare itself beforehand for the reasonable anticipation of being brought into the action as a successor in interest. Thus, any possible violations to the due process clause are absent. See: World-Wide Volkswagen Corp. v Woodson, 444 US 286, 292 (1980) and Keeton v Hustler Magazine, No. 81-1489, slip op. at 2 (1st Cir., June 16, 1982).

Therefore, although the order dismissing the amended counterclaim was correct within the procedural framework that the court utilized, we deem that fairness requires that Garlam be given an opportunity to move for a Rule 25 substitution, if the circumstances so

dictate.14/ Both parties must be given an opportunity to gather information and explore the issue of liability thus framed and to present their position as to the applicable law on corporate liability; see note six, the convenience of the forum, the possibility of a transfer, the type of summons required or whatever other arguments they deem relevant to the situation. We forewarn Garlam that if it decides to request substitution it must adequately support its motion,15/ and, in view of our rather extensive consideration of these issues, we expect Garlam, as well as the other parties, to come

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14/ If Explo assets are insufficient to satisfy that part of the judgment exceeding the policy, for example.

15/ Cf. Marcano v Offshore Venezuela, C.A., 497 F. Supp. 204 (EDLa. 1980) (individual seeking to prosecute action as legal representative of deceased had to make proper showing to that effect before Rule 25(a) substitution was granted).

forth with well researched and adequately grounded positions. We are painfully aware that the end result of this ruling may well be an additional dilation of this ten year old case, yet to leave the matter as it stands is a blow to fairness[16/] and by doing so we would be inviting more delay and appeals.

Accordingly, the Motion for Reconsideration is DENIED. Defendant counterclaimant Garlam is ORDERED to file within fifteen (15) days after notice of this Order a motion for substitution in accordance with Rule 25(c) Fed. R. Civ. P., at which time the Court shall order that summons be served on Rocket and thereafter a hearing shall be held to

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16/ It is only fair to at least permit Garlam to enter the "dark and dismal forest known to all as the corporate reshuffle." Moody v Albemarle Paper Company, 50 FRD 494 (EDNC 1970).

determine if Rocket is in fact the successor in interest of Explo, Garlam's judgment debtor.

SO ORDERED.

At San Juan, Puerto Rico, on November 16, 1982.

CARMEN CONSUELO CEREZO
United States District Judge

72740

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF PUERTO RICO

EXPLOSIVES CORPORATION OF AMERICA,	)	
Plaintiff	)	
vs	)	CIVIL 72-0001CC
GARLAM ENTERPRISES CORPORATION and FEDERAL INSURANCE COMPANY	)	
Defendants	)	

OPINION AND ORDER

Rockcor, Inc. (Rockcor) formerly known as Rocket Research, Inc., a publicly held corporation incorporated in the State of Washington and having its principal place of business in that state, has been summoned before this court to substitute Explosives Corporation of America, (Explo) judgment-debtor and plaintiff herein, as its suc-

cessor in interest. Rockcor was duly served with process on September 1, 1983 in Washington. After many continuances, an evidentiary hearing was set for June 28, 1984. On that date, however, the parties informed that there was no need for a hearing and submitted the issue by documentary evidence and legal memoranda.

The facts which originated the present controversy between the parties are as follows. As a result of a contract negotiated between Explosives Corporation of America (Explo), a subsidiary of then Rocket Research Corporation, and Garlam Enterprises Corporation (Garlam) for the pre-splitting and blasting operations required in the construction of a certain part of Las Américas Expressway in Puerto Rico, Explo filed this lawsuit against Garlam and its surety, the Federal

Insurance Company, on January 3, 1972 alleging breach of contract and requesting payment of $300,000 in damages. Garlam filed a counterclaim also alleging breach of contract and demanding $4,120,000 in damages. After four years of litigation the trial of the case was bifurcated and the issue of liability under the contract was tried without a jury on January 26-30, 1976. Prior to any decision on the issue of liability but after trial on that issue Excoa, Inc. (Excoa), Explo's successor by merger, was dissolved by consent of its sole stockholder, Rocket Research Corp., on October 29, 1976. On that date certain lands known as the Preston property, which had belonged to Explo and then to Excoa by reason of the merger, were conveyed to Rocket Research Corp. in lieu of foreclosure of the mortgage given on

October 8 to secure payment of a debt in the amount of $5,575,029.00 owed by Excoa to Rocket Research Corp. In a separate document the remaining assets of Excoa were transferred to Rocket Research Corp. in partial satisfaction of a debt Excoa had with Rocket Research Corp. Among the "property" so conveyed was "all of /Excoa's/ interest in and to that lawsuit pending in the United States District Court, / t/he District of Puerto Rico being Cause No. 1-72 entitled Explosives Corporation of America vs Garlam Enterprises Corporation and Federal Insurance Company, General Insurance Company of North America, third party defendant." Excoa's dissolution, like Explo's merger, was not notified to Garlam or to the court. Thereafter, on March 30, 1977, this Court, by Senior District Judge W. A. Bootle of the Middle

District of Georgia sitting by designation, decided the issue of liability in favor of Garlam and against Explo.

On September 9, 1977 Garlam filed a motion for substitution of parties under Rule 25(c) stating that it had found out about Explo's dissolution from answers to its interrogatory submitted in preparation for the hearing on damages and requesting that Explo be substituted by Rockcor, Inc. On November 10, 1977, however, Garlam filed an amended third-party complaint including Rockcor as a third-party defendant alleging that this corporation was Explo's alter ego since 1971. Rockcor's motion to dismiss the complaint for lack of personal jurisdiction was first denied by Judge Pesquera on July 22, 1979. On reconsideration, the motion was granted and judgment was entered on October 30, 1979 dismissing

the complaint as to Rockcor. The Court then held that Rockcor was not "doing business" in Puerto Rico within the interpretation of International Shoe v. Washington, 326 US 310 (1945) and could not be subjected to suit in this jurisdiction. An appeal of that judgment was dismissed for lack of jurisdiction under 28 USC Section 1291 on December 20, 1979. Thereafter, upon Garlam's motion for reconsideration, the Court reviewed the matter once more and concluded that jurisdiction could not be asserted over Rockcor for purposes of the amended third party complaint since its contacts with this forum occurred after the commencement of the action and to consider Explo's contacts as binding on Rockcor would be tantamount to a determination that Rockcor was Explo's alter ego since the beginning of this action.

Nevertheless, the court considered the possibility of bringing Rockcor into the action in substitution of Explo as its successor in interest and determined that Rockcor's involvements with the forum upon acquiring Explo's interests in this proceeding would be sufficient for purposes of examining if Rockcor was Explo's successor in interest and should be made a party in substitution of Explo. Given the circumstances of the case and the fact that Rockcor knew about the case having monitored the proceedings since it acquired Explo's interests in it, the Court in fairness to Garlam allowed it to move for substitution under Rule 25, Fed. Rules of Civ. Proc. It is Garlam's motion for substitution and Rockcor's

opposition thereto that are before us now for disposition.[1/]

In its motions opposing substitution under Rule 25 Rockcor insists that its acquisition of Excoa's assets upon dissolution and its monitoring of this case since then are insufficient contacts with this forum to justify exercising personal jurisdiction over it. As explained in our Opinion and Order of November 16, 1982 the considerations involved to determine whether jurisdiction lies for purposes of filing a claim directly against a party are different from those involved in a determination on whether a party should substitute as its successor

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[1/] On November 16, 1982 an order was issued adopting the Special Master's findings on the issue of damages and judgment in favor of Garlam was entered on that date for the total sum of $2,423,177.00 without costs, pre-judgment interest or attorney's fees.

in interest the original party, against whom a claim was filed or judgment entered. Jurisdiction will not be premised on the mere acquisition of assets by the successor but on the existence of certain conditions which can make the purchaser of those assets a successor or an extension of the original party. As such, it will be liable for any obligations incurred by the original party within the forum. Jurisdiction would exist over the successor to the extent that there was jurisdiction over the original party.

Generally, "a purchasing corporation does not assume the liabilities of its predecessor unless (a) the purchaser expressly or implicitly agrees to assume liability; (b) the purchase is a de facto consolidation or merger; (c) the purchaser is a mere continuation of the

seller; or (d) the transfer of assets is for the fraudulent purpose of escaping liability" Meisel v. M & N Modern Hydraulic Press Co., 97 Wash 2d 403, 645 P. 2d 689, 690 (1982) citing 15 W. Fletcher, Cyclopedia of Law of Private Corporations, Secs. 7118-7123 (rev. ed. 1973). See also Hall v. Armstrong Cork, Inc., 692 P. 2d 787, 789-790 (Wash. 1984); Martin v. Abbott Laboratories, 102 Wash. 2d 581, 689 P. 2d 368, 384 (1984). This rule has been accepted by the majority of American jurisdictions. See Dayton v Peck, Stow & Wilcox Co. (Pexto), 739 F 2d 690, 692 (1st Cir. 1984) and Cashar v Redford, 28 Wash App. 394, 624 P.2d 194, 195 (1981).

Garlam contends that by acquiring all of Excoa's interest in this lawsuit Rockcor expressly assumed liability for the counterclaim. This contention is

based on its interpretation of the word "interest" as encompassing both beneficial as well as adverse interests. It appears, however, from the contract itself, as well as from the deposition of Rockcor's Chairman of the Board, Mr. George Sutherland, that this was not the meaning given to the term by the parties to the bill of sale. The "interest" in this lawsuit conveyed to Rockcor by the bill of sale was one of several properties conveyed in partial satisfaction of Excoa's debts to Rockcor. This "interest" was one of Excoa's assets at the time of the transaction. Clearly, what was transferred to Rockcor was Excoa's right to collect from Garlam the amounts claimed by Explo in this lawsuit. Aside from the fact that we cannot ascribe property qualities to Garlam's counterclaim against Explo, other than as

a property of Garlam, it is dubious that a creditor would accept a debt in payment of its credit. Rockcor did not expressly assume this liability and its acquisition of Excoa's interest in this lawsuit cannot, by itself, justify imposing liability against it for the amounts due by Explo on the counterclaim. For the same reasons it cannot be said either that Rockcor impliedly assumed that liability.

Garlam argues that upon acquiring all interests in this suit Rockcor accepted the terms of the subcontract between Explo and Garlam. Quoting article XX of that agreement which provides that it would "bind the heirs, executors, administrators, successors, holding companies and assigns of the parties hereto" it claims that Rockcor became an "assign" of Explo and is now responsible for the

latter's breach in the performance of the contract. The quoted clause can only mean that persons within the categories mentioned can be held responsible for any breach of contract committed by the original parties to the contract. See 4 Corbin on Contracts, section 871, note 80, and cases cited therein, especially George v. Richards, 361 Pa. 278, 64 A. 2d 811, 813 (1949). By acquiring all interests in this action, however, Rockcor did not acquire the contract as an "assignee," which under the provisions of the same could not be assigned without Garlam's written consent and which had been terminated upon Garlam's taking over and completing the subcontractor's work, but merely acquired an action for damages arising from an alleged breach of contract. Cf. 4 Corbin on Contracts, Section 886, as to assignability of such

right of action. Rockcor is not an "assignee" of the subcontract and is not liable in such capacity for Explo's breach. Neither was Rockcor a "holding company" of Explo within the strict meaning of such term. See 6A Fletcher Cyc. Corp. (Perm. Ed.) Section 2821.

Garlam does not allege that the dissolution of Excoa and the sale of its assets to Rockcor was in fact a merger or consolidation of that corporation with Rockcor. It claims, however, that by paying for and controlling this litigation, without notice to the court and under Explo's name, it became a "mere continuance" of the dissolved corporation. Having acquired all of Excoa's interests in this action Rockcor, as sole stockholder of a dissolved corporation, could, however, assume the costs and control of the litigation in order to

protect Excoa's interests. See RCWA Section 23A.28.250.

The "mere continuation" exception to the general rule that the purchaser of assets of a corporation is not liable for his predecessor's liabilities "is less clearly defined than the other . . . /exceptions/." Parson v Roper Whitney, Inc., 586 F Supp 1447, 1450 (W.D. Wis. 1984). It has been said that "'/ t/he key element of a 'continuation' is a common identity of the officers, directors and stockholders in the selling and purchasing corporation.'" Dayton, 739 F 2d, 693 quoting from Leannais v Cincinnati, Inc., 565 F 2d 437, 440 (7th Cir. 1977). See also Cashar, 624 F 2d 196. Other factors such as continuation of the seller's business practices and policies and "the sufficiency of consideration running to the seller corporation in

light of the assets being sold" have also been considered. Id. Although Rockcor and Excoa had certain officers and directors in common at the time of dissolution, complete identity did not exist in the person of the vice president of each of the corporations and in a number of directors of Rockcor who were not directors of Excoa. It may be argued that there was identity of ownership since Rockcor was the sole stockholder of Excoa and its shareholders indirectly owned Excoa. Nevertheless, to find that continuity exists merely because there was common management and ownership, without considering other factors, is to disregard the separate identities of the corporations without the necessary considerations which justify such an action. See 1 Fletcher Cyc. Corp., (Perm. Edition) section 43.20. Although common

management and ownership are a crucial element in determining "continuation," other factors must be considered in order to impose liability upon the successor. Aside from the fact that control of Excoa by Rockcor to such extent as to make the former an "alter ego" of the latter has not been proven, the doctrine of disregarding the corporate entity is distinct from the question of a successor's liability, which is the issue presented by Garlam's motion. See 1 Fletcher Cyc. Corp. (Perm. Ed.) Section 48. See also Meisel, 645 P. 2d, 692 citing Harris, Washington's Doctrine of Corporate Disregard, 56 Wash. L. Rev. 253, 253 n. 3 (1981), and 1 W. Fletcher, Private Corporations, Section 48, at 276 (rev. ed. 1974).

In this case the seller corporation dissolved and its trade name and opera-

tions were discontinued. Although Rockcor has expanded its business affairs, it is uncontroverted that it did not continue Excoa's business of manufacturing and distributing explosive products. Garlam did not prove that the consideration paid for Excoa's assets was insufficient. The evidence showed that at the time of its dissolution Excoa owed Rockcor approximately $5,600,000. Garlam alleged that the conveyance to Rockcor of the Preston property was made without fair consideration because no appraisal was made of the properties prior to the transfer. Although it may be a good practice to require an appraisal before a certain property is conveyed in payment of debts, this, by itself, would not show lack of fair consideration. The evidence showed that several years later an appraisal was made and the value of the

property was estimated at $550,000, approximately $140,000 more than the book value. In 1980, that is almost four years after the dissolution of Excoa, this property was sold for $1,120,000. Even if we consider this as the true value of the Preston property, we cannot determine that Excoa's assets, the main asset being these lands, were worth more than the $5,600,000 owed by Excoa to Rockcor. Garlam did not dispute the existence of this debt nor its amount. On this record we cannot conclude that Rockcor is a "mere continuity" of Excoa.

Garlam also contends that the transfer of Excoa assets to Rockcor was for the fraudulent purpose of avoiding liability on its counterclaim. Citing a fifth exception to the general rule that a purchaser of a corporation's assets does not thereby become liable for its

debts, Garlam argues that Rockcor is not a "good faith" purchaser and should, therefore, be held responsible for Excoa's liabilities. This fifth exception applicable where "some of the elements of a purchaser in good faith /are/ absent," is encompassed within the fourth exception quoted above which involves a fraudulent transaction. See: Dayton, 739 F. 2d, 692, n. 1. Section 19.40.040, RCWA quoted by Garlam in support of its contention that the transfer of Excoa's assets to Rockcor was fraudulent, provides that "every conveyance made and every obligation incurred by a person who is or will be thereby rendered insolvent is fraudulent as to creditors without regard to his actual intent if the conveyance is made or the obligation

is incurred without a fair consideration."

The "good faith" aspect of the exception is included in the Washington's statute [sic] defining "fair consideration" thus:

> Fair consideration is given for property, or obligation,
>
> (1) When in exchange for such property, or obligation, as a fair equivalent therefore, and in good faith, property is conveyed or an antecedent debt is satisfied, or
>
> (2) When such property, or obligation is received in good faith to secure a present advance or antecedent debt in an amount not disproportionately small as compared with the value of the property, or obligation obtained. RCWA Section 19.40.030 (emphasis ours).

It is undisputed that upon its dissolution immediately following the transfer of its assets to Rockcor, Excoa was an insolvent corporation. As stated above, however, neither the true value of

Excoa's assets was shown nor that its assets were worth more than Excoa's indebtedness to Rockcor. The validity of that debt has never been questioned. Garlam argues, notwithstanding, that Rockcor did not purchase Excoa's assets in good faith when it "stripped" its subsidiary of all its assets to the prejudice of innocent creditors such as itself and when it did not notify Garlam [of] its intention to dissolve Excoa. In addition, it claims that Rockcor cannot be considered a purchaser in good faith since it caused to be filed deceptive articles of dissolution with the Washington State authorities. The case of Harrison v Puga, 4 Wash. App. 52, 480 P. 2d 247 (1971) cited in support of Garlam's contention that a stockholder who strips a corporation of all assets transfers the same to its own account and

becomes liable for the debts of the corporation is inapplicable to the instant situation which involves a successor liability claim. In that case, the transfer of the corporation's assets to the stockholder was made without any apparent consideration and with the stockholder's clear intent to disregard the corporation's separate entity by treating its assets as his own. By contrast, evidence of corporate disregard has not been presented in this case. Moreover, Rockcor's acquisition of Excoa's assets was in its capacity as creditor of the corporation, in payment of debts whose validity has not been disputed.

To establish "good faith," as used in section 19.40.040 of the Washington revised statutes, the party carrying the burden of proof must show one or more of

the following three factors by substantial evidence:

> (1) an honest belief in the propriety of the activities in question;
>
> (2) no intent to take unconscionable advantage of others; and
>
> (3) no intent to, or knowledge of the fact that the activities in question will hinder, delay, or defraud others. Sparkman and McLean Co. v Derber, 4 Wash. App. 341, 481 P. 2d 585, 591 (1971), quoting Tacoma Association of Credit Men v Lester, 433 P. 2d 901, at 904 (Wash. 1967).

Although the burden of proof is initially upon the party alleging fraud, under certain circumstances this burden has been found to shift to the purchaser to prove the good faith of his transaction with an insolvent. Sparkman v. McLean, 481 P. 2d, at 591. One such circumstance has been held to be where the same individuals control two or more

businesses which are dealing together. Id., see Tacoma Association, 433 P. 2d, 904-905. Although we have previously stated that control of Excoa by Rockcor to a degree which would justify disregarding the separate entity of these corporations has not been shown and is not in issue, sufficient control existed as would justify requiring Rockcor to prove good faith in the transaction. See Tacoma Association, 433 P. 2d, 904-905.

Rockcor's Chairman of the Board, Mr. George Sutherland, stated in an affidavit submitted in evidence that the decision to dissolve Excoa was unrelated to this case and that it took place before any judgment had been rendered in favor of Garlam, at a time when the corporation expected Explo to prevail against Garlam. In his deposition, Sutherland expressed that same view and

further stated that one of the purposes of the transaction was to benefit from certain tax consequences resulting from Excoa's liquidation. This was the reason for culminating the same before the end of the fiscal year, which ended on October 31, 1976. Evidence more contemporary to the transaction, a letter of October 8, 1976 to Rockcor's Vice President and Treasurer at the time, Mr. Robert G. Sanderson, from the corporation's financial counselor shows that this was, in fact, considered in making the decision to dissolve Excoa.

There is nothing in the record to dispute the Sutherland statements and the Court cannot pass upon the credibility of this witness, the parties having waived the hearing and submitted the issue on the documentary evidence alone.

Citing Rainier National Bank v. Mc Cracken, 26 Wash. App. 498, 615 P. 2d 469, 474-475 (1980). Garlam alleges that sufficient "badges or indicia of fraud" exist to conclude that the conveyance of Excoa's assets to Rockcor was fraudulent. These "badges" of fraud are, according to Garlam, the insolvency of Excoa, the lack of consideration for the conveyance, the relationship between the contracting parties, the pendency of this suit, the secrecy or concealment of the transaction, departure from the usual method of business and the transfer of Excoa's entire estate. See Rainier National Bank, 615 P. 2d 474. Although some but not all of these circumstances are present in this case, the transaction has not been shown to be fraudulent. This is so in light of Rockcor's evidence showing honest belief that Explo would prevail in

its claim against Garlam and that its motivations in the transaction were not related to this suit. It cannot be overlooked that Garlam's credit, if any, was but a contingent claim at the time of the transaction. Moreover, it cannot be stated that Rockcor tried to take "unconscionable advantage" of others by securing its multimillion [sic] credit, something Garlam could have done also by attaching property of Explo to secure payment of the judgment ultimately entered. Rockcor having showed "good faith" in the transaction with Excoa, and lack of a fair equivalence in the value of the properties conveyed in satisfaction of the debt not having been shown by Garlam, it must be concluded that fair consideration was given for the conveyance and that the same was not fraudulent

within the meaning of section 19.40.040, RCWA.

None of the exceptional circumstances for imposing liability upon a purchasing corporation for the debts of its predecessor having been shown, the Motion for Substitution of Parties is hereby DENIED.

SO ORDERED.

At San Juan, Puerto Rico, on August 7, 1985.

CARMEN CONSUELO CEREZO
United States District Judge

72738

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF PUERTO RICO

EXPLOSIVES CORPORATION OF AMERICA,	'	
	'	Civ. 72-0001CC
Plaintiff	'	
vs	'	
GARLAM ENTERPRISES CORPORATION and FEDERAL INSURANCE COMPANY,	'	
	'	
Defendants	'	

OPINION AND ORDER

Explosives Corporation of America (Explo), plaintiff-counterdefendant, now judgment debtor, filed on August 15, 1985, a motion for Post Judgment Relief under Rules 59 and 52(b), Fed.R.Civ.P. Based on principles of collateral estoppel, it argues that the judgment of November 12, 1982 must be amended to conform it to the findings of fact and conclusions of law made by the Superior

Court of Puerto Rico, San Juan Part, in a judgment dated June 12, 1982 in Civil case 76-1431 Garlam Enterprises Corp. v. The Puerto Rico Highway Authority. We must tread the trail that led to this motion in order to understand it.

On August 8, 1985 we ruled that Rockor, Inc. was not the successor in interest of judgment debtor Explo. This ruling disposed of a motion for substitution filed by defendant-couterclaimant Garlam Enterprises Corp. (Garlam) under Rule 25, Fed.R.Civ.P., which in turn had been ordered to be filed by the court according to our Memorandum Opinion and Order of November 16, 1982 where Garlam's request for reconsideration of the court's October 1979 dismissal of Garlam's third-party action against Rockor, Inc. was denied, but the possibility of a post judgment substitution

was discussed. Since November 16, 1982 we had entered judgment in favor of Garlam for $2,423,177.00 pursuant to another Opinion and Order issued on that same day which adopted the Special Master's findings on damages. The issue of liability for the breach of the construction work contract between the parties was decided by visiting Judge Bootle in an Opinion and Order dated April 4, 1977.1/ On November 24, 1982

1/ This case was transferred to the undersigned's docket during the third quarter of 1980. After the Special Master filed his Report on April 1980, the parties filed numerous motions objecting to the Master's conclusions, questioning his integrity and challenging Judge Bootle's ruling on liability. The court held a hearing on June 1981 to discuss the possibility of submitting additional evidence. At the same time that these motions were being filed, Garlam also requested reconsideraion of Judge Pesquera's October 1979 dismissal of the third-party action against Rockor, Inc.

(See next page.)

Explo filed a document entitled Motion Under Rule 59 and/or Rule 52(b), Fed. R. Civ. P., stating that it had come upon a copy of the judgment issued by the Superior Court of Puerto Rico on June 15, 1982 in Garlam Enterprises Corporation v. Autoridad de Carreteras that would have a definite impact on the case once it became final. Explo argued that the findings of fact by the Commonwealth Court revealed "that Garlam might have been compensated by the Highway Authority for items Garlam claimed from plaintiff herein." Based on this it requested that

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(Continued from previous page.)

[sic] The reconsideration motions and opposition were referred to Judge Pesquera on February 1982 but he disqualified himself from ruling on them in July 1982. Our November 16, 1982 rulings dealt with the challenges to the Master's report and with the soundness of Judge Bootle's liability ruling as well as with the reconsideration of Judge Pesquera's dismissal.

we make new findings, without specifying which; that the award of damages to Garlam be reduced by an unspecified amount in excess of 1.9 million, without advancing any definite reasons for it, and that Explo be granted twenty more days to file a memorandum where it would set forth in detail the arguments and factual data necessary to support this motion. An opposition to this Rule 59/52(b) motion was filed by Garlam on November 29, 1982 contending that Explo was dissolved, nonexistent corporation which should not be allowed to continue making appearances before the court. On November 29, 1982 Garlam also filed a Motion under Rule 52 and/or Motion under Rule 59 and/or Motion under Rule 60 which was opposed as untimely. On December 14, 1982, Explo filed a memorandum in support of its Rule 59/52(b) motion urging that

since Garlam was able to recover from the Puerto Rico Highway Authority (PRHA) for excess costs due to faulty design, it should be allowed to reduce Garlam's award in this case as an equitable adjustment. On January 12, 1983 Garlam filed a more detailed opposition to Explo's request to alter the judgment. It now argued that the facts and issues in the case before the Puerto Rico Superior Court were entirely different from those in this action, thus making res judicata and collateral estoppel inapplicable. Explo replied on February 3, 1983 again arguing in favor of amendment. An order of February 16, 1983 denied Garlam's motion since, as a Rule 52/59 motion, it was untimely and as a Rule 60 motion, it failed to state specific reasons. On this same date, Explo's Rule 59/52(b) motion of November 24, 1982 was also

denied as vague and speculative. Explo's memorandum of December 14, 1982 was considered by the Court as an untimely motion under Rule 59/52(b). We expressly stated that Explo's November 24, 1982 motion in which it requested twenty more days to state what it should have included then was just an attempt to circumvent the ten day jurisdictional term of Rule 59 and that its December 14, 1982 memorandum could not be considered for lack of jurisdiction. Explo then filed a Notice of Appeal from the November 16, 1982 judgment and the February 16, 1983 order denying its Rule 59/52(b) motion of November 24, 1982.

While the Rule 59/52(b) controversy was pending, Garlam filed on December 15, 1982 the Rule 25 petition to substitute Explo with Rockor, Inc. [sic] as judgment debtor, as suggested by the Court, and so

began the process to summon the out of state party to be substituted. Explo opposed the Rule 25 motion and what ensued was a battle which lasted almost two years, prompted in part by Rockor's [sic] obstinacy in failing to even recognize the court's jurisdiction to determine whether substitution was proper. In the midst of this procedural joust, Explo's appeal of the November 18, 1982 judgment was dismissed for the Court of Appeals understood the judgment was not final for purposes of an appeal since the Rule 25 motion was pending resolution.

In view of this ruling, Explo renewed its requests for Rule 59/52(b) amendments to the November 16, 1982 judgment and filed a motion and memoranda based essentially on the same grounds as its December 1982 memorandum, only this time

within ten days of what it considers to be the "final judgment:" our Opinion and Order of August 8, 1985 disposing of the Rule 25 motion. This renewed motion was opposed by Garlam on January 17, 1986. The final twist to this imbroglio came on October 10, 1985 when the Circuit Court dismissed Garlam's appeal of the November 16, 1982 judgment which it filed after we ruled on the Rule 25 motion, confident perhaps that all "pendent" matters precluding an appeal had been resolved. Not so. The Court said that Garlam itself had claimed in the prior appeal effort that the November 1982 judgment was not final and the ruling on the lack of finality of our November 1982 judgment was "the law of the case." The Court also pointed out that there was a post-judgment motion pending and that "it appears that no final judgment has been

entered in this matter." The court mentioned that "adjudication of Garlam's motion for substitution of parties in and of itself does not constitute entry of a final judgment" and drew our attention to this "absence" of an entry of judgment so that we clarify or correct it.

We view the Circuit Court's reference to the lack of finality of the November 1982 judgment as a voluntary declination of their jurisdiction to entertain an appeal of this case rather than as a determination of its finality for other purposes of law. The November 16, 1982 judgment disposed of <u>all</u> claims against <u>all</u> parties. This is precisely why we said in our November 16, 1982 Memorandum Opinion and Order that Garlam's reconsideration had to be denied but a post-judgment Rule 25 motion could be considered. We explained in that order

the implausibility of joining Rockor as a third-party defendant in an ongoing litigation where liability had already been established but considered that the substitution of Rockor as a successor in liability of judgment debtor Explo was possible through the mechanism of Rule 25 which may be used even after a judgment is final because of the separateness of the Rule 25 procedure from the establishment of liability in a given case. The difference between joining a party to an ongoing litigation and substituting a litigant that is already part of an ongoing litigation is that the joinder looks to the new party's relationship to litigation whereas the potential Rule 25 substitute looks to its relationship to the party already in the case and not to the nature of the case. It must also be pointed out that finality of judgment for

purposes of appeal is not necessarily the same as finality for other purposes, such as, for example, preclusive effects of the judgment. See Miller Brewing Co. v. Jos. Schlitz Brewing Co., 605 F.2d 990, 995-96 (7th Cir.), cert. denied, 444 U.S. 1102 (1980).

The fact that Explo's Rule 52(b)/59 motion can be entertained does not explain why it waited until November 24, 1982, when our judgment was already final in terms of preclusive effects, to bring to our attention the Superior Court's judgment of June 15, 1982. Explo has not explained either why it never sought intervention in the Commonwealth case or why it did not request joinder of the claim against Garlam for the equitable unit price reduction it could have allegedly derived from Garlam's contract with the PRHA. The record shows that the

Superior Court case was known and monitored by Explo throughout the years. Explo continuously referred to the pleadings filed in that case and even submitted part of the Superior Court's record as evidence for the Special Master to consider in his determination of damages. Explo's argument that it was not necessary for it to intervene in the Superior Court action because that case dealt with other matters is self-defeating. The Puerto Rico Rules of Civil Procedure allowed Explo to appear in that action to plead precisely the third-party beneficiary status theory that it has now attempted to introduce in this case. Likewise, it could have joined as a party in the two actions. Instead, it adopted a wait and see attitude and never formally raised this new theory of equitable price reduction in

this litigation or in the one before the Superior Court. See Parklane Hosiery Co. v. Shore, 439 U.S. 322, 329-331 (1978).

Res judicata and collateral estoppel are doctrines which service purposes of convenience and practicality in avoiding multiple litigation as well as in furthering the public interest in finality of controversies. See Itco Corp. v. Michelin Tire Corp., Com. Div., 722 F.2d 42, 50 (4th Cir.), cert. denied, ___ U.S. ___, 105 S. Ct. 1191 (1985). They are to be raised affirmatively and at the earliest moment to minimize the harm to the other party, see Evans v. Syracuse City School Dist., 704 F.2d 44, 47 (2d Cir. 1983); Nevels v. Hanlon, 656 F.2d 372, 375-76 (8th Cir. 1981), and to maximize the interests they serve. It must also be remembered that res judicata is essentially an equitable doctrine that should

not be applied to reach inequitable results. See Walsh v. Intern. Long Shoremen's Ass'n., AFL-CIO, 630 F.2d 864, 875 (1st Cir. 1980). Application of the doctrines to the particular circumstances of this case in the manner sought by Explo will result in an inequitable and absurd situation, not the least justified by movant's conduct. The presentation of this matter after the court had already ruled on all pending matters and had entered a final judgment[2/] further undermines its untimely request for the application of res judicata or collateral estoppel. See John v. Rogers, 621 F.2d 300, 305 (8th Cir. 1980); Southern Pacific Communication Co. v. American Tel. & Tel. Co., 567 F.Supp. 326, 329

2/ The final judgment was preceded by a partial judgment and multiple rulings entered before those issued in the Superior Court.

(D.C.D. 1983), aff'd. 740 F.2d 1011 (D.C. Cir. 1984), cert. denied, ___ U.S. ___, 105 S.Ct. 1359 (1985). Its blatant inaction before the Puerto Rico or federal courts in failing to raise this equitable right to benefit from the main contract theory, also belies the validity of its argument. Cf. Macko v. Byron, 555 F.Supp. 470, 480 (N.D. Ohio 1982), aff'd. 760 F.2d 95 (6th Cir. 1985) (having defendants consented by inaction to separate trials of defamation and civil rights issues, they could not now assert a victory in the state case as a technical bar to the federal claim). Furthermore, even considering Explo's collateral estoppel argument as a timely one, it has failed to meet its burden of proving that preclusion applies in the manner suggested. See Manning v.

Grimsley, 643 F.2d 20, 23 (1st Cir. 1981).

First of all, Explo's characterization of the two judgments as being preclusive is erroneous. The Commonwealth case to which Explo was never a party originated as a result of Garlam's dissatisfaction with the payment for the completed work by the owner of the construction project. That work involved much more than the blasting of rock, and that action was based on a specific contract between Garlam and PRHA. Garlam, as the principal contractor for the project, sought recovery for general excess costs on completion of the entire work which it deemed were the result of the owner's deficient planning and other shortcomings. The Superior Court in its judgment of June 15, 1982 reduced Garlam's claims of excess costs to

$2,466,318.73. The court made specific findings on many items of the general overall construction work and it did not rule on any matter dealing with Explo's subcontract for the blasting of the rock. It did not need to, for Garlam did not litigate this aspect of the general construction work in that case in view of the pending federal action where this matter was being litigated. The blasting item was not even specified in the general construction contract but was included in the general item of excavation work. Thus, the Superior Court's judgment does not conflict or preclude the judgment in this case. Rather, the two judgments complement each other. In the Commonwealth case, the court ruled as to the construction work as a whole and on the duties and liabilities in relationship between the main contractor and

the owner. In the present case, the Court adjudicated the controversies on a specific part of the overall construction work, the blasting and pre-splitting of rock pursuant to the contract between Explo, the blaster-subcontractor, and Garlam, the principal contractor. Contrary to Explo's contention, Garlam did not recover twice from the PRHA and Explo for the blasting performed by it when Explo abandoned the job. Garlam obtained regular compensation from PRHA for the blasting it had to perform upon Explo's default. The excess cost of completing the blasting phase it chose to recover from Explo in the instant case, rather than claiming it from the PRHA in the Commonwealth case, as was its contractual prerogative. The 1982 findings of the Superior Court of Puerto Rico as to PRHA's defective preconstruction stud-

ies and plans, do not reveal that the excess costs which Garlam recovered from Explo for the blasting were necessarily the result of these errors. These findings have to be limited to what the Superior Court had before it: the payment for the complete construction project according to the contract between Garlam and the PRHA. The fact that the Superior Court concluded that the PRHA's design of the project as a "balanced" one was erroneous, in view of a mistake in the interpretation of the photogrametric survey on which the design was based, does not support the leap taken by Explo in contending that this error in design also contributed to all the excess costs that Garlam recovered from it for completion of the blasting phase. It is simply impossible to determine from the Superior Court's opinion

just how this defect could have affected Explo's liability. The Superior Court found that the error in the photogrametric study consisted in projecting the ground line higher than actual because dense vegetation in some areas distorted the photography. The result of this was that the project was not "balanced" and Garlam had to obtain fill material from an adjoining pit to "balance" the cuts, the excess costs of which Garlam recovered from the PRHA in the Superior Court case. There is no finding or comment in the Superior Court's judgment on how this design error affected the blasting or as to the hardness or particular quality of the rock, Explo's battle cry throughout these proceedings and its justification for having to abandon the work prematurely. Moreover, upon Explo's own request, the

Special Master in our case considered evidence related to many, if not all, of Garlam's contentions against the PRHA in the Superior Court case and examined their effect on Explo's limited responsibilities in the overall construction work. The Special Master specifically reduced, from approximately five million to two million dollars, many of the items requested by Garlam from Explo, including costs to obtain fill material in view of the Superior Court case and the design error theory, which the Special Master considered. The Special Master, as we indicated in our Opinion and Judgment of November 12, 1982, took painstaking care to distinguish Explo's contribution to Garlam's excess costs in completing the blasting work from the faults of the PRHA in other aspects of the project which also contributed to excess costs. The

Superior Court's judgment of June 15, 1982 did not touch upon any of these matters which were specifically ruled upon by the Special Master in our case.

Explo seems to indirectly recognize the separateness and uniqueness of each of these two actions. Its main challenge is that Garlam should have exercised its right to seek readjustment of the unit price per the Garlam-PRHA's general construction contract's clause 4.3,[3/] in

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3/ As indicated in our translated copy of the superior court's judgment part of the clause reads:

> 4.3 Increased or Decreased Quantities of Work-The Authority reserves the right to make any alterations in plans and changes in the quantity of work and in the quantity of materials to be furnished as may be necessary or desirable to fully complete the proposed construction in a satisfactory manner and the contractor shall perform the work in accordance with the changed plans. It is recognized that these changes are normal

(See next page.)

view of the Superior Court's finding of a more than 25% overrun. Explo contends that Garlam's failure to assert this contractual right with respect to the blasting portion of the overall construction should now preclude it, or collaterally estop it, from recovering

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(Continued from previous page.)

and expected adjustment and that they do not permit changes or modifications of the contract prices provided the resulting overruns or underruns from the quantities in the proposal do not exceed reasonable percentages. These percentages and the method to be followed are fixed as a part of the contract as follows:

3(d) It is mutually agreed, that, if demand is made by either party, overruns or underruns in any or all items resulting in a sum total change of more than 25% of the total cost of the contract calculated from the original proposal quantities and the original contract unit price, shall require a supplemental agreement signed by the Director and the Contractor setting forth the necessity for the change and the adjustment of unit prices agreed upon as satisfactory to both parties.

excess costs for blasting from Explo. Explo argues that as a construction contract subcontractor it has an equitable right to benefit from this price readjustment clause and to reduce its liability to Garlam in proportion to the renegotiated unit price Garlam should have obtained from the PRHA for the blasting work. It requests an additional evidentiary hearing to determine the exact reduction. This argument is more a motion for reconsideration of the findings of Judge Bootle in 1977, and of the Special Master's in 1980, than a Rule 52(b)/59 motion to alter judgment on grounds of collateral estoppel. In any event, it has many flaws. First of all, the Superior Court's finding on a 25% overrun cannot be telescoped into this case and the particular contractual relationship that was here considered. It

just cannot be determined from that judgment how the overrun percentage would apply specifically to the Explo-Garlam item of work. Clause 4.3 does not provide that for a certain percent of overrun the unit price will be modified in a certain way. It merely permits the parties to renegotiate the price. It would be sheer speculation to say what Garlam and the PRHA would have negotiated as a reasonable unit price of work for a particular item of work which was not even specifically included in the general construction contract. Furthermore, the clause's own language defeats Explo's interpretation. It starts out by stating how the owner has "the right to make any alterations in plans and changes in the quantity of work and in the quantity of materials to be furnished as may be necessary or desirable to fully complete the

proposed construction in a satisfactory manner and the contractor shall perform the work in accordance with the changed plans." The clause provides that these changes are considered normal and in protection of the contractor's rights; should they be in excess of 25%, the contractor may demand negotiation. The language of this clause presupposes that the overrun be attributed to the PRHA change or alteration of plans. The Superior Court decision does not specifically connect those changes or alterations caused by the PRHA that increased the overall costs and enabled Garlam to renegotiate, with the blasting item of work. The Special Master, however, found that Explo's breach, by itself, contributed to the excess costs of the blasting portion. There is nothing preclusive or contradictory between the

Superior Court's decision and ours on this particular matter. To the contrary, if Explo's theory were feasible, the Superior Court would probably have rejected it for some of the excess costs of the blasting were attributed to Explo, and PRHA could convincingly argue that the renegotiation provided in clause 4.3 was unjustified unless PRHA were liable for the excessive costs incurred in completing the blasting.

The second tier in Explo's collateral estoppel challenge is the conclusion that the contract between Garlam and the PRHA and the subcontract between Explo and Garlam can be juxtaposed harmoniously to permit Explo to obtain a renegotiated unit price for the blasting. More than an application of res judicata preclusion, this requires that we interpret the contractual rights of Garlam, Explo and

PRHA pursuant to each of their contractual relationships. The Superior Court did not make any finding on such an interplay. In our case, Judge Bootle was not placed by Explo in a position to make this finding. As for the Special Master, he did not have to wander into speculative situations such as this to determine the issue of damages given the specific provisions in the subcontract that deal with the abandonment of performance. It should also be noted that this equitable adjustment claim was never formally incorporated in the pleadings nor was it an essential theory of the case which focused on whether Explo's abandonment of

the project was justified because of the rock's hardness.4/

In any event, an examination of the contracts mentioned according to the legal principles designed for such analysis, P.R. Laws Ann. title 31 sections 3471, et seq., reveals that the contracts cover very different situations and

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4/ Way back in 1972 when this litigation commenced, the central issue was precisely whether Explo had to blast the rock to a certain average size. Judge Bootle found that the contract required that fragments be of a certain size and that Explo was having trouble fulfilling this requirement. Hence, the importance of the hardness of the rock. During the damage assessment stage of the litigation before the Special Master, Explo's central concern with the design error which caused the project to be an "unbalanced" one, lay in preventing Garlam from recovering from Explo the excess costs of the material brought as fill to balance the excavations which, as we mentioned, wa in fact considered by the Special Master and reduced from Garlam's claim against Explo. The precise manner in which this design error affected the original question regarding the rock's hardness has never been addressed to by Explo.

responsibilities and cannot be interpreted as Explo contends, even assuming we should entertain its request. The general construction contract between Garlam and the PRHA dealt with a number of work items that depended upon each other, were subject to many factors and covered a longer period of time. Explo's performance under its subcontract with Garlam had to depend upon the general contract's requirements and performance schedules. However, this is not tantamount to incorporating into the subcontract the rights of Garlam under the principal contract. There is no mention of any such subrogation right with respect to Explo's unit price for blasting. An integrated reading of Explo's subcontract and an understanding of its role in the general construction project reveals otherwise. Explo's work was one of the first items

in the schedule. It was paid following a very detailed process according to amount of rock satisfactorily blasted and there were specific provisions for changes in the amount of work. After a certain section of blasting was performed, the main contractor, Garlam, would remove and clear the materials blasted and would then ascertain whether the blasting was satisfactory, that is, whether the rock fragments left averaged a certain size. Explo was contracted to blast a certain amount of rock at a given unit price. The subcontract, however, covered the situation in which extra blasting had to be performed. Pursuant to Art. VIII(g) the parties had to agree before extra work could be performed. Garlam, on the other hand, was paid by PRHA for the finished product based on a prestipulated price. If it had to incur additional work to

complete the projects, then it ran the risk of a nonprofitable venture. In Explo's case, if more blasting was necessary, it could obtain additional compensation from Garlam for the increased work or pack its bags and leave.

In sum, we have two separate contractual relationships between two different parties in two very distinct situations. The duties and liabilities of each are quite different and depend basically on interpreting the obligations arising from each one of the contracts involved. In the instant case we have examined the contractual relationship between Explo and Garlam. It was under that contract that Judge Bootle determined the issue of liability. The Special Master applied the specific provisions and the formula of the subcontract relative to the recov-

ery of damages upon abandonment of work. There was no need then, nor is there any now, to consider or apply any other standard. In addition, Explo's equitable right of subrogation stands on very weak grounds, considering the fact that it was Explo who abandoned the contract in the first place.

The full faith and credit statute requires that federal courts give final judgments of state courts preclusive effect, as such preclusion is applied between state adjudicative forums. 28 U.S.C. 1738; Migra v. Warren City School Dist. Bd. of Educ., 465 U.S. 75 (1984); Kremer v. Chemical Const. Corp., 456 U.S. 461 (1982). In Puerto Rico, the doctrine of claim and issue preclusion is codified in article 1204 of the Civil Code, P.R.

Laws Ann., Title 31 section 3343 which provides:

> Only a judgment obtained in a suit for revision shall be effective against the presumption of the truth of the res judicata.
>
> In order that the presumption of the res judicata may be valid in another suit, it is necessary that, between the case decided by the sentence and that in which the same is invoked, there be the most perfect identity between the things, causes and persons of the litigants, and their capacity as such.

The Supreme Court of Puerto Rico has rejected the trend in some jurisdictions of abandoning the mutuality or identity requirement, in view of the Civil Code's express mandate on this aspect. A & P Gen. Contractors v. Asoc. Cańa, Inc., 10 Official Translations of the Opinions of the Supreme Court of Puerto Rico 983, 110 D.P.R. 753 (1981). The identity of persons requirement mentioned by the Code is

also met "whenever the litigants of the second suit are legal representatives of those who litigated in the preceding suit, or when they are jointly bound with them or by the relations established by the indivisibility of prestations among those having a right to demand them, or the obligation to satisfy the same." Title 31, Section 3343. The "thing" referred to by the Civil Code is the object to matter over which the action is exercised, Lausell Marxuach v. Díaz Yañez, 3 Official Translations of the Opinions of the Supreme Court of Puerto Rico 742, 103 D.P.R. 533 (1975), while cause is "the principal ground, the origin of the actions or exceptions raised and decided . . . " Id.

In the present case one cannot conclude that there exists the "most perfect identity" in person, cause and thing

between the Superior Court case and this federal litigation. The parties are by no means identical nor can they be considered legal representatives. Each case deals with a different contractual relationship covering quite distinct performances and liabilities. The judgment of the Superior Court case did not adjudicate any matter with respect to the Explo-Garlam subcontract. The overrun finding in that caes has to be viewed within the context of the different controversies before that court. The fact that the Superior Court found no fault in the PRHA for the overrun of the construction project is not preclusive of Judge Bootle's prior finding that Explo was at fault regarding its particular duties under the blasting subcontract. Contrary to the Superior Court's general findings of overrun attributed to PRHA, the

Special Master distinguished which excess costs could be attributed to Explo's fault in breaching the contract and which were the result of other parties. Absent a specific finding by the Superior Court with respect to the blasting portion of the construction, the object of the case before us, we see no reason to ignore the Special Master's specific findings on this matter based on an untimely and unsound collateral estoppel challenge. As to Explo's contention that it should be entitled to a unit price reduction, the Superior Court judgment made no findings so as to to conclude that this contractual interpretation of both contracts should be applied in this case through collateral estoppel. If Explo pretends to raise this issue by way of a disguised reconsideration, there is no need to reconsider the prior rulings on

liability or the Special Master's findings and application of the method specified by the subcontract for the determination of damages in the event of abandonment of the work. In addition, Explo's failure to channel this claim through the proper procedure and its delay in presenting it to this court, also contributes to divest its petition of any discernible equitable or legal value, or, for that matter, any sense in terms of the purposes behind this case and issue preclusion doctrine, given the trajectory of this protracted litigation.

Explo's Motion for Post Judgment Relief under Rules 59 and 52(b) Fed. R. Civ. P. of August 15, 1985, is hereby DENIED. Considered as a Rule 60(b) Fed. R. Civ. P. motion for reconsideration, it is also DENIED. For purposes of

an appeal, the Clerk shall enter this Opinion and Order as a Final Judgment.

SO ORDERED AND ADJUDGED.

At San Juan, Puerto Rico, on March 6, 1986.

CARMEN CONSUELO CEREZO
United States District
Judge

72398

Supreme Court, U.S.
FILED
OCT 7 1987
JOSEPH F. SPANIOL, JR.
CLERK

No. 87-204

In the Supreme Court of the United States

OCTOBER TERM, 1987

EXPLOSIVES CORPORATION OF AMERICA,
GENERAL INSURANCE COMPANY OF AMERICA,
ROCKCOR, INC.,
PETITIONERS,

v.

GARLAM ENTERPRISES CORPORATION AND
FEDERAL INSURANCE COMPANY, INC.,
RESPONDENTS.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

RESPONDENT'S BRIEF IN OPPOSITION

CHARLES A. CORDERO
CORDERO, MIRANDA & PINTO
P.O. Box S-1311
Old San Juan, PR 00902
(809) 756-5966
Counsel for Respondent

Blanchard Press, Inc., Boston, Mass. — Law Printers [617] 426-6690

I

RESTATEMENT OF QUESTIONS PRESENTED

1. Whether the Court of Appeals correctly substituted, pursuant to Rule 25(c), Fed.R.Civ.P., a wholly-owned subsidiary for its holding company as the real party in interest when:

a) the holding company contractually agreed to be bound by the acts of its subsidiary;

b) the holding company dissolved its subsidiary without notification to respondent, a statutory creditor, and transferred *all* of the subsidiary's assets, including all interest in this litigation, to itself; and

c) the holding company financed and controlled this litigation, in the name of its dissolved subsidiary, to defend and protect its own interest without proper and timely notice to the court or to respondent.

2. Should this Court review the unanimous decision of the Court of Appeals which affirmed the district court's award of damages when there is no conflict between the circuits or with a decision of this Court, and the case is nationally insignificant.

II

THE PARTIES

Respondent is Garlam Enterprises Corporation ("Garlam"). Federal Insurance Company, Inc. has not been a party to the appeal nor does it have any interest in the present dispute.

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ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

RESPONDENT'S BRIEF IN OPPOSITION

Restatement of the Case

I. NATURE OF THE CASE

This is a contract dispute case wherein respondent, Garlam, proved to the courts below that Explosives Corporation of America ("Explo")[1] breached its contract commitments and caused Garlam damages in excess of 2.4 million dollars.

[1] In 1973, Explo was merged with an entity known as Excoa, Inc. ("Excoa") which assumed all its debts and liabilities. In 1976 Excoa was "liquidated and dissolved" and all its assets conveyed to Rocket Research Corporation, now known as Rockcor, Inc. ("Rockcor"). The district court was never notified of the Explo-Excoa merger nor of Excoa's dissolution until after entry of judgment on the liability issue.

II. Restatement of Facts

A. *Introduction*

Petitioners present a series of "undisputed facts" in support of their allegation to the effect that the Court of Appeals erred in substituting Explo for its holding company, Rockcor. Petitioner belabors that the *only* reason the non-existent subsidiary was substituted for its holding company (Rockcor) was because the latter financed and controlled this litigation. However, the true facts, as established by the courts below, present a different scenario.

The dispute between Garlam and Explo commenced over fifteen years ago. In January 1972, after breaching its contract with Garlam, Explo egregiously sued Garlam in the United States District Court for the District of Puerto Rico (Civil No. 72-0001) alleging breach of contract. Garlam counterclaimed against Explo and its surety, General Insurance Company of America ("GICA"), for Explo's breach and willful non-compliance with the contract. (A. 58-63).[2]

By agreement between the parties, the case was bifurcated (A. 68) wherein the issue of liability was tried on January 26-30, 1976 before Judge W. A. Bootle, Senior U.S. District Court Judge sitting by designation. On March 30, 1977, judgment on the liability issue was entered by Judge Bootle holding that Explo had breached its contract with Garlam and:

> "...that the real reason for abandonment of the project by Explo was not any breach or failure of performance on the part of Garlam, but was Explo's decision to abandon what for it was proving to be an unprofitable contract." (A. 1482-1500).

Accordingly, judgment was entered against Explo and its surety, GICA, on the issue of liability; damages were to be proven at a later trial (A. 1500).

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[2] Page references to the 7-volume Appendix used before the Court of Appeals are cited "A. __." Page references to the Appendix contained in the instant petition are cited as "__a".

The parties stipulated that the issue of damages was to be referred to a Special Master (A. 1560-1564). After reviewing all the relevant evidence and holding an evidentiary hearing, on April 24, 1980 the Special Master found that Garlam sustained $2,423,177 in damages caused by Explo's breach (A. 1879-1896). On November 16, 1982, the district court entered judgment in favor of Garlam and against Explo and its surety in the sum of $2,423,177. In that judgment, the liability of Explo's surety, GICA, was fixed at the policy limits of $1,230,000 (252 n.1a.).

B. *The Propriety of Substitution*

The Garlam-Explo contract reads in its pertinent parts:

> " ARTICLE XX — BINDING OF HEIRS, EXECUTORS, ADMINISTRATORS, SUCCESSORS AND HOLDING COMPANIES."
>
> "It is mutually agreed that this agreement shall bind the heirs, executors, administrators, *successors*, *holding companies* and *assigns* of the parties hereto." (emphasis added) (A. 4019).

On the first page of the Garlam-Explo contract Explo called itself:

> "...Explo contractors, a division of Explosives Corporation of America which in turn is a subsidiary of Rocket Research Corporation, hereinafter referred to as subcontractor...".

According to the testimony of Dr. Sutherland (Chief Executive Officer of Rockcor and Explo/Excoa) the Garlam-Explo contract was negotiated in Puerto Rico by Hugo E. Oswald and John W. Goode (A. 3250-51). Mr. Goode signed the Garlam-Explo contract in Puerto Rico before a notary public on May 5, 1971 (A. 4019). At that time, Mr. Oswald was a lawyer, a director and officer of both Rockcor and Explo

(A. 3251). In 1971 when the Garlam-Explo contract was signed, Rockcor owned 92% of the Explo stock (A. 3245), and Explo had six (6) directors and officers of which four (4) were also directors and officers of Rockcor (A. 3249, 3254). In 1973 Rockcor organized Excoa with the purpose of merging it with Explo and gaining full (100%) control over Explo (A. 3256). Thereafter, overlapping directors continued until Rockcor caused Explo/Excoa's dissolution in 1976 (A. 3256).

Garlam at all times insisted as a condition to the Garlam-Explo contract that it was to bind Rockcor, the holding company of Explo. From the inception of the contract, indeed even before the signing of the contract, Rockor knew of the existence of the contract, and the Rockcor Board of Directors expressly acted upon the terms of the contract by securing and guaranteeing a $1.2 million dollar performance bond so that Explo could commence work in Puerto Rico (A. 3267). An indemnity agreement was also signed in 1971 between Rockcor and Explo's surety covering the Garlam-Explo contract which surety remains in force to this day (A. 3268).

Over ten (10) years ago, in 1976, upon causing the dissolution of its wholly-owned subsidiary (Explo/Excoa) without notice to the court or to respondents, Rockcor secured all interest in and to this lawsuit. The exact wording on the Bill of Sale is:

> "*All* of party of the first parts [sic] (Excoa's) interest in and to that lawsuit pending in the United States District Court, the District of Puerto Rico being Cause No. 1-72 entitled Explosives Corporation and Federal Insurance Company, General Insurance Company of North America, third party defendant." (emphasis added).

It is emphasized that the assignment of all of Excoa's (Explo's) interest in this lawsuit and its subsequent dissolution was never made known to the court or to Garlam until after entry of judgment on the liability issue. Moreover, the Bill of Sale surfaced after 1983 when Garlam was authorized by the

court to conduct post-judgment discovery on the issue of a Rule 25(c) substitution. The assignment does *NOT* exclude the Garlam counterclaim. Indeed, Rockcor's Chairman of the Board, Dr. Sutherland, admitted that Rockcor was aware of Garlam's counterclaim since its inception (A. 3261), and further admitted that Rockcor's attorney, Stuart G. Oles, had been representing Explo even before the commencement of this lawsuit. Rockcor also filed yearly status reports of the litigation with the Securities Exchange Commission. Dr. Sutherland further admitted that after the Explo-Excoa merger, Mr. Oles continued representing Explo while he simultaneously represented Rockcor during the various "special appearances" before the district court. The same attorney (Mr. Oles) also represents the surety, GICA (A. 3261), and now represents Rockcor in this Court.

Rockcor was well aware that upon accepting an assignment of *all* interest in this lawsuit it was exposing itself to also accepting the Garlam counterclaim. After Rockcor caused the dissolution of Explo/Excoa in 1976, Rockcor began paying all litigation expenses even before the entry of any adverse judgment against Explo. Thus, since Rockcor received all of Excoa's assets after its dissolution, the only interest Explo/ Excoa had in defending the Garlam counterclaim was to protect Rockcor's interest as guarantor of Explo's 1.2 million dollar performance bond.

Notwithstanding, petitioners allege that when Rockcor acquired from Explo/Excoa *all* interest in and to this lawsuit, it only agreed to accept the beneficial aspect of same, i.e., if Explo was successful in its claim, Rockcor would receive the payment of damages; but if Explo was unsuccessful in its defense Explo would pay nothing because it was a dissolved corporation. Succinctly stated, Rockcor played the "heads I win, tails you lose game" with the lower courts. The Court of Appeals unanimously rejected petitioners' attempts, finding that "litigation is a two-way street. Once it is entered it must be travelled the full length;. . ." (60a).

In view of the aforestated facts and the applicable legal principles discussed *infra*, the Court of Appeals for the First Circuit found that substitution was proper under Rule 25(c), Fed.R.Civ.P. In its opinion, the Court of Appeals stated that:

> "For the following reasons, we hold that Rockcor is liable for the full amount of the judgment against Explo and must be substituted for Explo as the defendant to Garlam's counterclaim: Rockcor from the beginning was the controlling stockholder of Explo/Excoa; it succeeded to Explo/Excoa's interest in the lawsuit; after the merger of Explo into Excoa and Excoa's dissolution, Rockcor became the real party in interest, indeed the only party in interest; Rockcor financed andcontrolled the litigation; and Rockcor is bound under the contract between Explo and Garlam as Explo's successor and a holding company of Explo." (59-60a.)

C. *Damages Were Correctly Awarded by the Courts Below.*

The courts below found that Explo's failure to perform its contract commitments or its abandonment of the project was not justified.[3] As a result of Explo's breach and willful non-compliance with the Garlam-Explo contract, petitioners were charged, according to the express conditions of the contract (A. 4010-11), with the costs and damages sustained by respondent in completing the work Explo had agreed to perform.[4]

The Court of Appeals, following the decision of the district court, rejected petitioners' allegation to the effect that the Garlam-Explo contract entitled them to equitable renegotia-

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[3] Petitioners flagrantly misstate that Explo was terminated. However, it was clearly proven and established by the district court and adopted by the Court of Appeals, that Explo abandoned what for it was proving to be an unprofitable contract.

[4] The Garlam-Explo contract estimated that the quantity of rock to be blasted at 2 million cubic meters, *subject to overruns and underruns* (A. 4016).

tion of unit prices for rock blasting. The Court of Appeals correctly pierced through petitioners' attempt to interchange or merge the provisions of two totally independent and unrelated contracts in support of its allegation, and found that:

> "Explo seems to argue that it had a right of renegotiation of unit prices if the actual work quantities differed substantially from the Highway Authority's estimate. There was, however, no such provision in Explo's contract and the district court's ruling was correct. Moreover, there was no evidence before the district court that Explo's production was affected in any way by the work quantity estimates of the Highway Authority. The difficulties between Explo and Garlam stemmed from three factors: oversize rock fragments, low quantity of material blasted, and the slow work progress." (17a)

The provisions of the Highway Authority-Garlam contract *only* affected Explo insofar as they prescribed the work to be done and the time of performance (A. 217).

The Court of Appeals further rejected petitioners' argument that it was charged for completing a materially larger contract than that previously agreed upon. The Court of Appeals concurred with the district court's decision to the effect that the Special Master, to whom the parties had referred the issue of damages,:

> "... applied the correct legal principles in making his findings, which were supported by the evidence and not clearly erroneous. We rule specifically that Garlam carried its burden of proof on damages. There is no basis in the contract or the evidence for finding that Explo was entitled to an equitable price increase. Nor are we impressed with Explo's argument that Garlam failed to mitigate its damages and, hence, is precluded from recovering. This overlooks the fact that, after Explo breached its contract, Garlam was under time constraints

in its prime contract with the Highway Authority to complete the blasting within a comparatively short time.[4] The measure of damages was, as the district court found, the actual and necessary additional costs reasonably incurred by Garlam in order to complete the work required by Explo by the subcontract. The amount arrived at by the Master reflected accurately the application of this damages formula."

"[4] Explo had agreed to do the work by September 22, 1972" (22-23a).

Reasons for Denying the Writ

I. THE DECISION OF THE COURT OF APPEALS ORDERING THE SUBSTITUTION OF A WHOLLY-OWNED AND DISSOLVED SUBSIDIARY ("EXPLO") FOR ITS HOLDING COMPANY AND SUCCESSOR IN THIS LITIGATION ("ROCKCOR") AS THE REAL PARTY IN INTEREST, PURSUANT TO RULE 25(c), FED.R.CIV.P., DOES NOT CONFLICT WITH THE DECISIONS OF THIS COURT NOR WITH THE DECISIONS OF OTHER CIRCUITS.

A. *The Court of Appeals Fully Considered and Correctly Decided the Issue of Substitution.*

The Court of Appeals found that Explo should properly be substituted for Rockcor as judgment debtor for the following reasons:

1. *Rockcor, as a Holding Company, Contractually Agreed To Be Bound by the Acts of Its Wholly Owned Subsidiary, Explo.*

It is undisputed that at the time the Garlam-Explo contract was executed, Rockcor owned almost all (92%) of Explo's outstanding stock, and controlled the Board of Directors of Explo by sitting four of its (Rockcor's) own directors on a six-man Explo board. Rockcor knew of the existence of the Garlam-Explo contract from its inception, and expressly acted

upon its terms by securing a 1.2 million dollar performance bond on behalf of Explo. Rockcor further signed an indemnity agreement with its surety guaranteeing Explo's performance.

This Court in *North American Company* v. *S.E.C.*, 327 U.S. 686, 701 (1946), defined a holding company as:

> "The dominant characteristic of a holding company is the ownership of securities by which it is possible to control or substantially to influence the policies and management of one or more operating companies in a particular field enterprise."

See also General Foods v. *Mass. Dept. of Public Health*, 648 F.2d 784, 789 n.6 (1st Cir. 1981), citing with approval *Astron Industrial Associates* v. *Chrysler Motors Corp.*, 405 F.2d 958 (5th Cir. 1968) for the proposition that a parent corporation with overlapping management can be bound by a subsidiary.

The Court of Appeals found it evident that Rockcor was a holding company of Explo at the time the contract was executed (59a). As such, Rockcor expressly agreed to be bound by the terms of the Garlam-Explo contract which was negotiated and signed in Puerto Rico by one of Rockcor's officers. (*See* relevant part of Article XX of the Garlam-Explo contract reproduced *supra* at page 3 wherein the parties agreed to bind "*holding companies*".) Rockcor accepted the Garlam-Explo contract, expressly acted upon it, and never objected to the aforementioned clause. Hence it was properly substituted as a judgment debtor because, as Explo/Excoa's holding company, it contractually agreed to be bound.

2. *Rockcor Is Liable to Respondent as a Successor Judgment Debtor.*

Petitioners acknowledge that there are four factual situations in which a corporation that purchases the assets of another corporation may be held liable for the debts or obligations of the transferor corporation; to wit: (a) when the pur-

chasing corporation expressly or impliedly agreed to assume the selling corporation's liability; (b) when the transaction amounts to a consolidation or merger between the purchaser and seller corporations; (c) when the purchaser corporation is merely a continuation of the seller corporation; or (d) when the transaction is entered into fraudulently to escape liability for such obligations. *Cyr* v. *B. Offen & Company, Inc.*, 501 F.2d 1145 (1st Cir. 1974); *see also Golden State Bottling Company* v. *NLRB*, 414 U.S. 168, 182 n.5 (1973); *Dayton* v. *Peck, Stow & Wilco Co.*, 739 F.2d 690, 692 (1st Cir. 1984); *Gee* v. *Tenneco, Inc.*, 615 F.2d 857 (9th Cir. 1980); *Leannais* v. *Cincinnati, Inc.*, 565 F.2d 437, 439 (7th Cir. 1977); *R. J. Enstrom Corp.* v. *Interceptor Corp.*, 555 F.2d 277, 281-82 (10th Cir. 1977). (All cited with approval by petitioners at page 7n.6).

Hence, the purchaser of all the assets of a corporation can be liable if that purchaser, like Rockcor, falls into any of the above categories. For the following reasons, Rockcor falls into at least three (3) of the above factual situations:

a) *Rockcor Expressly Agreed To Accept All Interest in and to This Litigation.*

As previously stated, Rockcor secured from its wholly-owned subsidiary (Explo/Excoa) *ALL* interest (beneficial or adverse) in this lawsuit. (*See* Bill of Sale reproduced in the Restatement of Facts *supra* page 4). The assignment of "*ALL*" of Explo-Excoa's interest in this lawsuit to Rockcor was not notified to the court nor to respondent, a statutory creditor, until after entry of judgment on the issue of liability. Notwithstanding, the assignment did not exclude respondent's counterclaim. Before the entry of any adverse judgment against Explo, Rockcor was the sole owner of the Garlam-Explo dispute. Conversely, since Rockcor received **all** of Excoa's assets after its dissolution, the only interest Explo-Excoa had in defending the Garlam counterclaim was to protect Rockcor's interest (Rockcor was the bond guarantor) (A. 3315).

When substitution was first sought Rockcor had already succeeded to Explo/Excoa's interest to the suit, was financing the litigation, as discussed *infra*, and had agreed to indemnify the bonding company in the event of a judgment against Explo. (56a). The Explo-Garlam Contract, "Article XX" *supra* at page 3, likewise binds "assigns" and "successors". Rockcor cannot dispute that after it dissolved Explo/Excoa it was the successor to Explo/Excoa and under the Explo-Garlam contract (which it accepted without protest) it is bound to accept the judgment.

Hence, Explo was properly substituted by Rockcor because Rockcor succeeded Explo/Excoa in this litigation (and also to the assets from which respondent could satisfy the judgment rendered in its favor) (53a); *See Minnesota Mining and Manufacturing Co.* v. *Eco Chem, Inc.*, 757 F.2d 1256 (Fed. Cir. 1985).

The Court of Appeals correctly concluded that "after the merger of Explo into Excoa and Excoa's dissolution, Rockcor became the real party in interest, indeed the only party in interest". (59a).

b) *Rockcor Is Merely a Continuation of Its Subsidiary, Explo.*

By using Explo as a "front" in this lawsuit and by paying for all litigation costs even before any adverse judgment was entered, Rockcor became a continuation of Rockcor solely for the purpose of protecting its own interest as guarantor of the performance bond.

The Court of Appeals also found that the district court's focus of Rockcor as a separate entity from Explo/Excoa "was misdirected; it should have been on the relationship between Rockcor and Explo/Excoa and the role Rockcor played in the litigation." (49a). From that view, it is undisputed that in this litigation Rockcor continued as an active litigant against Garlam before and after it caused the Explo/Excoa dissolution.

c) *The Dissolution of Explo/Excoa and the Subsequent Transfer of All Assets to Rockcor Was Not Notified to Respondent, a Statutory Creditor.*

Although the Court of Appeals did not address this issue, the record shows that neither Explo/Excoa nor Rockcor ever bothered to notify respondent or respondent's attorneys of Excoa's dissolution, although they were all represented by the same attorneys.

Petitioners are all subject to the laws of the State of Washington with regard to corporate dissolution and the rights of creditors. Under the laws of the State of Washington, RCWA 19.40.010, a creditor is defined under the Fraudulent Conveyance Act as follows:

> "Creditor is a person having any claim whether matured or unmatured, liquidated or unliquidated, absolute, fixed or contingent."

Likewise, the same Washington statute defines a debt as follows:

> "Debt includes any legal liability, whether matured or unmatured, liquidated or unliquidated, absolute, fixed, or contingent."

Accordingly, at the time of the dissolution of Excoa, Rockcor knew, and had sufficient notice of the fact, that under the law respondent was a creditor, and that Excoa had a potential debt owed to respondent. Rockcor gave Garlam no opportunity to intervene in the dissolution process and protect its claim against Excoa prior to dissolution.

The "Notice to Creditors" (A. 3972) required by Washington State law, 23A.28.020 and 23A.28.040, was admittedly not notified to respondent (A. 3305). Such lack of notice by Excoa and Rockcor constitutes fraud, or at least, bad faith conduct.

Furthermore, Rockcor admits that at the time of dissolution no appraisal of the assets of Excoa was ever made (A. 3290) and that no independent Certified Public Accountant ever prepared a certified statement of the assets and liabilities of Excoa (A. 3325); certainly Rockcor cannot, in good faith, now claim that it gave "fair consideration" for the assets it received from Excoa since no independent entity ever certified the real liabilities, if any, Excoa had at the time of dissolution.

> "Determination of the issue of solvency, under the (Fraudulent Conveyance) statute, requires an appraisal of probable liabilities as well as the salable value of assets." *F. S. Bowen Elec. Company* v. *U.S. Fidelity & Guaranty Company*, 256 F.2d 46, 49 (4th Cir. 1958).

Such a transfer of assets to the sole shareholder of an insolvent corporation does not create a preference, nor is the sole shareholder considered a bonafide purchaser, *United States* v. *Adams Building Company*, 531 F.2d 342 (6th Cir. 1976).

This Court can glean from the above that the facts before the Court of Appeals were sufficient to hold that Rockcor's actions caused it to become a successor judgment debtor.

3. *Rockcor Directly Financed and Controlled This Litigation Before Any Adverse Judgment Was Entered.*

In its opinion, the Court of Appeals found still another ground for substitution since:

> "It has long been the rule that a nonparty who controls the litigation is bound by the judgment. 'The reason would be that the nonparty would have the power to determine what evidence and arguments should be offered in the litigation and, if appropriate, the appeal.' *General Foods Corporation* v. *Massachusetts Department of Public Health*, 648 F.2d 784, 789 (1st Cir. 1981). *See also Drier* v. *Tarpon Oil Company*, 522 F.2d 199 (5th Cir. 1975)

(president of corporation held liable because of privity and as a controlling person under 15 U.S.C. Section 77o [sic]; *Kreager* v. *General Electric Company*, 497 F.2d 468, 471 (2d Cir. [sic]) (sole shareholder of corporation bound by dismissal of first action brought in the name of his corporation), *cert. denied*, 419 U.S. 861 (1974); *Pan American Match, Inc.* v. *Sear, Roebuck & Co.*, 454 F.2d 871, 874 (1st Cir. [sic]) (subsidiary corporation sufficiently identified with its parent company to represent the legal rights of the parent), *cert. denied*, 409 U.S. 892 (1972); 1B J. Moore, J. Lucas & T. Currier, *Moore's Federal Practice and Procedure* Section 0.411[10] at 477-78 (1984 & Supp. 1986-87)." (53-55a).

By Rockcor's own admission after it caused the Explo/Excoa dissolution it continued paying litigation expenses to protect its own interest (A. 3315). Thus it is amply clear that Rockcor assumed the costs and control of the litigation in order to protect its own interest, and *NOT* to benefit Explo/Excoa's interests.

Accordingly, this Court has noted that:

"[O]ne who prosecutes or defends a suit in the name of another to establish and protect his own right, or who assists in the prosecution or defense of an action in aid of some interest of his own...is as much bound...as he would be if he had been a party to the record."

Montana v. *United States*, 440 U.S. 147, 154 (1979) (quoting *Souffront* v. *Compagnie des Sucries*, 217 U.S. 475, 486-87 (1910); *Alman* v. *Danin*, 801 F.2d 1 (1st Cir. 1986); (50-51a).

In light of the above findings of facts expressly established by the Court of Appeals, or which could otherwise easily be inferred from the record, the substitution of Explo (a wholly-owned and nonexistent subsidiary) for Rockcor (its holding company and successor in this litigation) was proper pursuant to Rule 25(c), Fed.R.Civ.P.

The decision of the Court of Appeals as to the issue of substitution, does *NOT* conflict with the case law cited by petitioners. To the contrary, respondent has cited the same case law in support of its own arguments.

Petitioners' allegations that the decision of the Court of Appeals conflicts with the decisions of this Court and other circuit courts lacks merit. Petitioners do not contest the legal principles or doctrines adopted by the Court of Appeals, but rather attempt to challenge the conclusions the Court of Appeals drew from the facts. The cases cited by Petitioners do *NOT* conflict with the Appellate Court's decision, and in fact support the opinion.

B. *The Issue of Substitution Lacks National Significance Sufficient To Warrant Review.*

Petitioners allege that the Court of Appeals erred in ordering that Explo be substituted for Rockcor (as shown above, the decision was correct). This Court has been reluctant to grant a writ of certiorari to review an allegedly erroneous decision because undue concentration on every error committed by the lower courts would transform the Supreme Court into another court of errors and/or appeals, contrary to its constitutional mission. *Ross* v. *Moffit*, 417 U.S. 600, 616-17 (1974).

Petitioners belabor that the only reason Rockcor was substituted as a judgment debtor was because it financed and controlled this litigation. Although such a finding is sufficient by itself to order substitution, the Court of Appeals clearly established that Rockcor's finance and control of this litigation was only one of the many facts present in favor of its finding that substitution was proper. (56-60a)

Certainly to the extent that a "correct" decision is a restatement of "settled law" (as in this case), review on certiorari becomes patently inappropriate. Petitioners have not shown a scintilla of evidence or cited any conflicting case law in support of its allegation to the effect that the decision of the Court

of Appeals departs from the accepted and usual course of proceedings, and thus, the present writ does not merit review. In addition, the facts in this case do not raise an issue of sufficient national significance to merit review by this Court.

Notwithstanding, petitioners attempt to devise an issue sufficient to merit review by speculating as to the "logical implications" the decision of the Court of Appeals may have in future cases regarding substitution. Neither the facts nor the applicable case law support petitioners' conclusory allegations.

II. PETITIONERS' ALLEGATION THAT DAMAGES WERE INCORRECTLY AWARDED ONLY INVOLVES A QUESTION OF EVIDENCE AND FACTUAL FINDINGS, AND THUS, DOES NOT MERIT REVIEW BY THIS COURT.

This issue has been adequately covered in this opposition and need not be repeated again (*see* pages 6 thru 8). Succinctly stated, the courts below awarded damages to respondent resulting from Explo's breach and willful noncompliance with the Garlam-Explo contract. Both courts soundly rejected petitioners' allegation to the effect that under the Garlam-Explo contract, Explo was entitled to renegotiation of unit prices for rock blasting (16-17a). The courts below further dismissed petitioners' allegations that they were charged with the costs of completing a materially larger contract than that previously agreed upon (22-23a). The award of damages to respondent was supported by the evidence.

Petitioners' challenge to the award of damages plainly seeks to abate the findings of fact established by the Special Master, the district court and reviewed and approved by the Court of Appeals. Nowhere do petitioners demonstrate any error, let alone clear error, the legal standard designed to reverse the award of the Special Master and the district court; Rule 52(a) Fed. R. Civ. P. The cases cited by petitioners are inapplicable or otherwise have no bearing on the determination of damages. Certainly, a well-reasoned award of damages based upon factual findings does not rise to the level of national importance nor does it merit review by this Court.

Conclusion

The decision of the Court of Appeals correctly substituted, pursuant to Rule 25(c), Fed.R.Civ.P., a wholly-owned and dissolved subsidiary (Explo/Excoa) for its holding company and successor in this litigation (Rockcor) as the real party in interest. Under the factual findings of this case, the Court of Appeals did not give Rule 25(c) a "unique" interpretation, nor does its decision to substitute conflict with any decision rendered by this Court or by other circuit courts of appeals.

Rockcor from the begining was the controlling stockholder of Explo/Excoa; it succeeded to the Explo/Excoa's interest in this lawsuit; after the merger of Explo into Excoa and Excoa's dissolution, Rockcor became the only party in interest; notice was not given to respondent, a statutory creditor, of Explo/Excoa's merger nor dissolution until after entry of judgment on the liability issue; Rockcor financed and controlled this litigation; and Rockcor is bound under the Garlam-Explo contract as Explo's successor and a holding company of Explo. Certainly, the cases cited by petitioners would mandate substitution under these findings of fact. Indeed, respondent relied upon the very same cases petitioners have cited as being contrary to the decision of the Court of Appeals. Thus, the decision of the Court of Appeals does not represent a departure from the accepted and usual course of judicial proceedings, nor does it conflict with the decisions of any other circuit.

Petitioners have been unable to raise an issue of sufficient national significance to merit review by this Court. The only issue petitioners raise is their unhappiness with the unanimous opinion of the Court of Appeals and the fact they will finally have to pay the damages resulting from their misconduct committed over fifteen (15) years ago. The Court of Appeals correctly followed the case law enunciated by this Court regarding substitution of a party in interest.

For all the aforesaid reasons, the petition for writ of certiorari to the United States Court of Appeals for the First Circuit should be DENIED.

Respectfully submitted,

CHARLES A. CORDERO
CORDERO, MIRANDA & PINTO
P.O. Box S-1311
Old San Juan, PR 00902
(809) 756-5966
Counsel for Respondent

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v.

GARLAM ENTERPRISES CORPORATION
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Respondents.

PETITIONERS' REPLY BRIEF

ON PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

CORRECTED COPY

STUART G. OLES
Counsel of Record, and
ARTHUR D. McGARRY
DOUGLAS S. OLES
OLES, MORRISON, RINKER,
STANISLAW & ASHBAUGH
3300 Columbia Seafirst Center
701 Fifth Avenue
Seattle, WA 98104
(206) 623-3427

SALVADOR ANTONETTI
FIDDLER, GONZALEZ & RODRIGUEZ
G.P.O. Box 3507
San Juan, Puerto Rico 00936
(819) 753-3113
Attorneys for Petitioners

October 20, 1987

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INTRODUCTION

Pursuant to Supreme Court Rule 22.5, petitioners Explo, Rockcor, and General Insurance herein reply to arguments first raised in Garlam's brief in opposition, including several flat out mischaracterizations of the record and proceedings below.

Our petition develops that the essential basis[1] upon which successor liability was imposed upon Rockcor for Explo's

[1] Garlam inaccurately characterizes our petition as arguing that "the *only* reason" for substitution of Rockcor was because it financed and controlled the litigation. Our petition addressed at pp. 8-9, in footnote 8, the untenable "holding company" analysis, which is considered further *infra*.

breach of the Explo/Garlam contract, was the First Circuit's determination that Rockcor financed and controlled Explo's litigation, after Explo's dissolution. That dissolution occurred in 1976 (prior to adjudication of the liability issue between Explo and Garlam) when Rockcor—in its capacity as a secured creditor (not as a shareholder)—foreclosed on Explo's assets, in partial satisfaction of a multi-million dollar debt owed by Explo to Rockcor (A. 302). Our petition argues that the imposition of successor liability upon such basis is untenable in light of well-established law, misapplies Fed. R. Civ. P. 25(c), and is a dangerous precedent threatening legitimate interests of creditors of insolvent parties.

Garlam's response is threefold. First, at pages 13-15, it argues that mere financing and control of litigation does justify imposition of successor liability under Fed .R. Civ. 25(c). We do not here reiterate our earlier argument.[2]

Second, Garlam argues that an alternative basis for Rockcor's liability is that one of its officers signed the Explo/Garlam contract, and that Rockcor contractually agreed to be bound as Explo's "holding company."

Third, it argues that liability is also appropriate under three of the four recognized exceptions to successor non-liability. We now develop how these two latter arguments newly and falsely characterize the record and proceedings below.

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[2] It should, however, be noted that nowhere does Garlam confront the critical distinction between being "bound" in the collateral estoppel sense of preclusion from relitigation, and being liable to pay a judgment. *See* discussion of cases relied upon by the First Circuit and Garlam at pp. 10-11, notes 9 and 10, of our petition.

A. It Is Untrue That One Of Rockcor's Officers Signed The Explo/Garlam Contract, Or That Rockcor Expressly Agreed To Be Bound By Its Terms, As A "Holding Company" Or Otherwise, And These False Assertions By Garlam Do Not Provide An Alternative Or Adequate Basis To Support The Imposition Of Successor Liability Upon Rockcor.

Garlam asserts at:

p.I "'[T]he holding company [Rockcor] contractually agreed to be bound by the acts of its subsidiary;"

p.4 "Garlam at all times insisted as a condition to the Garlam-Explo contract that it was to bind Rockcor, the holding company of Explo."

p.9 "As such, Rockcor expressly agreed to be bound by the terms of the Garlam-Explo contract which was negotiated and signed in Puerto Rico by one of Rockcor's officers."

The above statements misrepresent the record below. Appended hereto is a continuation of our petition's appendix. Reproduced at A352 thereof is the signature page of the Explo/Garlam contract. The only two parties there signing are"Garlam Enterprises Corporation contractor by Raymond W. Garffer, President," and "Explo Contractors, a division of Explosives Corporation of America by John W. Goode, General Manager." There is no evidence anywhere in the record that Mr. Goode had any actual or apparent authority to bind or act on behalf of Rockcor. The mere fact that Mr. Hugo Oswald, Jr., who was an officer and director of both Explo and Rockcor, "witnessed" (A. 352) the execution of the Explo-Garlam contract, plainly did not serve to transform the Explo/Garlam contract into an Explo/Rockcor-Garlam contract, and no contrary factual or legal authority has (or can be) cited to the contrary.

Garlam insists that Rockcor is liable to pay damages for Explo's breach of Explo's contract with Garlam, because the Explo-Garlam contract recited that their "holding companies" would be bound. Aside from the trial court's fact-finding (at A. 293) that Rockcor was not Explo's "holding company,"[3] there is another inseparable obstacle to this argument. While Explo may have agreed that its "holding company" would be bound, Rockcor did not. We reiterate that nowhere in the record is there even a scintilla of evidence that Mr. Goode (or Mr. Oswald, or anyone else for that matter) even purported to act for or bind Rockcor in negotiating or executing the Explo-Garlam contract, let alone that he was clothed with actual authority to do so. It is well to remember that the creation of either actual or apparent authority requires "written or spoken words or other conduct of the principal" (emphasis added). RESTATEMENT OF AGENCY (SECOND) 26 and 27 (1958). *See*, e.g., *Moreau v. James River-Otis, Inc.*, 767 F.2d 6 (1st Cir. 1985). The utter absence of evidence of such written or spoken words or other conduct by Rockcor is fatal to Garlam's argument.

B. Garlam's Argument Falsely States That The First Circuit Held That Rockcor Should Be Held Liable For Explo's Judgment On The Basis Of Three Of The Four Recognized Exceptions To The General Rule Of Nonliability Of Parent Corporations For Debts Of Their Subsidiaries.

At page 8 of the opposition brief, Garlam states: "The Court of Appeals found that Explo should properly be substituted for Rockcor as judgment debtor for the following

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[3] Curiously and inconsistently, the First Circuit both *accepts* the trial court's factual findings (A. 44), and conclusiorily asserts (without any analysis of the record, except to note that Rockcor owned all Explo's stock) that Rockcor became liable as a "successor" to Explo's subcontract obligations (A. 58-59).

reasons: . . . " It then outlines its argument under headings numbered 1 (the "holding company" argument) and 2(a), (b) and (c) which state:

> 2. Rockcor is Liable to Respondent as a Successor Judgment Debtor
>
> a) Rockcor Expressly Agreed to Accept All Interest in and to this Litigation.
>
> b) Rockcor Is Merely a Continuation of Its Subsidiary, Explo.
>
> c) The Dissolution of Explo/Excoa and the Subsequent Transfer of All Assets to Rockcor Was Not Notified to Respondent, a Statutory Creditor.

It just is not so. Garlam's three above quoted assertions as to the First Circuit's holdings are simply untrue. The First Circuit expressly left undisturbed the trial court's findings, including a finding that there was no factual basis to establish *any* of the four recognized exceptions. A. 280-308. Rather, the First Circuit believed Rockcor to be liable because it financed and controlled Explo's litigation, and because it considered Rockcor to be Explo's "holding company."

Garlam thus suggests that this Court should affirm a Circuit Court opinion which is otherwise erroneous (for the reasons developed in our petition) on alternative bases (the presence of three of the four recognized exceptions) which are undercut by trial court findings which the Circuit Court has left undisturbed. The suggestion is obviously untenable and improper. The mischaracterization of the First Circuit's true holding is equally improper.

Becuase Garlam's discussion concerning the applicability of the three exceptions is entirely fact based, we deem no reply necessary except with respect to its discussion of certain Washington statutes. Garlam's argument at pages 12-13 that

Washington State statutes (which are reproduced in the appendix hereto) provide alternative bases for substituting Rockcor as judgment debtor, is untenable. RCW 19.40.040 provides that conveyances by insolvent persons to creditors are fraudulent if made "without a fair consideration." RCW 19.40.030 provides that fair consideration exists when "an antecedent debt is satisfied." In our case, the trial judge concluded "that fair consideration was given for the conveyance (from Excoa to Rockcor) and that the same was not fraudulent within the meaning of section 19.40.040, RCWA." (A. 307-308.) This fact-based conclusion was not disturbed by the First Circuit and offers no basis for substituting Rockcor under Rule 25(c), Fed. R. Civ. P.

Garlam also argues that some kind of "fraud" or "bad faith" should be inferred from lack of "notice to creditors" under RCW 23A.28.020 and .040. The first of these statutes involves shareholder consent for voluntary corporate dissolution, and the second requires notice to the secretary of state when a corporation intends to dissolve. Neither statute requires any "notice to creditors." The trial court found that Garlam's entitlement as a creditor, "if any, was but a contingent claim at the time of the transaction" in 1976. (A. 307.) This finding was not disturbed by the First Circuit, and it follows that Rockcor cannot reasonably be substituted for Explo under the statutes cited by Garlam.

C. Explo Was Charged With More Than Costs To Complete Work As Bid.

At page 6 of the Brief in Opposition, Garlam contends that its damage award includes nothing more than costs of "completing the work Explo had agreed to perform." In fact, Garlam recovered its costs of blasting roughly 3 million cubic meters of rock when Explo originally subcontracted to perform

a part of Garlam's prime contract that was estimated at only about 1.5 million cubic meters. See Petition at p. 6.

In note 4 on page 6 of its Brief in Opposition, Garlam raises an argument that Explo's original subcontract required blasting of all overrun quantities (as ultimately performed by Garlam). To the extent this is true, however, Explo's subcontract expressly incorporated prime contract provisions promising an equitably renegotiated unit price for the excess work. *See* Petition at p. 6, note 5. As reflected in portions of the First Circuit's opinion quoted on page 7 of Garlam's Brief, the appellate court refused to credit Explo with the equitable price increase that was guaranteed by contract and common law.

Garlam's Brief does not even attempt to contradict Explo's authorities to the effect that terminated subcontractors must be credited with price adjustments for quantities of work in excess of those indicated in their original agreements.

CONCLUSION

Garlam's opposition mischaracterizes the record and proceedings below. It does not confront the essential issues raised in the petition.

DATED this 20th day of October, 1987.

Respectfully submitted,

STUART G. OLES
Counsel of Record, and
ARTHUR D. McGARRY
DOUGLAS S. OLES
OLES, MORRISON, RINKER,
STANISLAW & ASHBAUGH

SALVADOR ANTONETTI
FIDDLER, GONZALEZ & RODRIGUEZ
Counsel for Petitioners